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MEMORANDUM

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AZ CORP COMMISSION
DOCUMENT CONTROL

63305

TO: Docket Control
FROM: Ernest G. Johnson
Director
Utilities Division

DATE: June 6, 2002

RE: STAFF REPORT ON AEPCO AND SOUTHWEST TRANSMISSION
COOPERATIVE, INC.'S REQUEST TO AMEND DECISION NO. 63305 AND
REQUEST FOR FINANCING (DOCKET NO. ~~E-01773A-00-0227~~)

Attached is the Staff Report for AEPCO and Southwest Transmission Cooperative, Inc.'s application to amend Docket No. 63305 and request for financing authority. Staff recommends approval of the application, with one condition.

EGJ:JST:nms

Originator: John S. Thornton

Attachment: Original and ten copies

Arizona Corporation Commission

DOCKETED

JUN - 7 2002

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Docket No. E-01773A-00-0227

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**STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

AEPCO AND SOUTHWEST TRANSMISSION COOPERATIVE, INC.

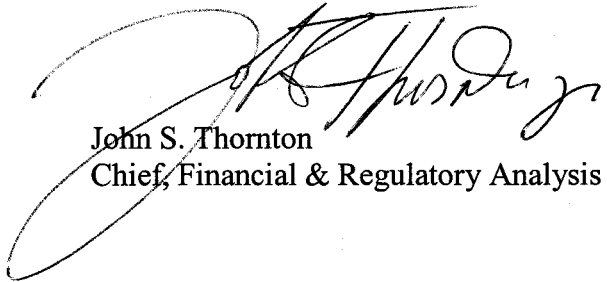
DOCKET NO. E-01773A-00-0227

**APPLICATION TO AMEND DECISION NO. 63305
AND
FOR AUTHORITY TO ISSUE DEBT**

JUNE, 2002

STAFF ACKNOWLEDGMENT

The Staff Report for AEPCO and Southwest Transmission Cooperative, Inc., Docket No. E-01773A-00-0227, was the responsibility of the John S. Thornton, who reviewed and analyzed the Companies' application.



John S. Thornton
Chief, Financial & Regulatory Analysis Section

EXECUTIVE SUMMARY

On March 20, 2002, AEPCO and Southwest Transmission, Inc. requested authority to amend Commission Decision No. 63305. That Decision, dated January 11, 2001, granted AEPCO authority to issue up to \$21,510,515 from the Rural Utilities Service-Federal Financing Bank ("RUS-FFB"). Subsequently, AEPCO was restructured into three affiliated entities pursuant to Decision No. 63868, dated July 25, 2001: AEPCO, Southwest Transmission Cooperative, Inc., and Sierra Southwest Cooperative Services, Inc. That restructuring authority transferred transmission-related assets to Southwest Transmission Cooperative, Inc., but it did not transfer and divide AEPCO's existing financing authority among the three affiliated entities.

AEPCO and Southwest Transmission Cooperative, Inc. now request that the financing authority granted in Decision No. 63305 be transferred to the new AEPCO and Southwest Transmission Cooperative, Inc. in the following manner:

AEPCO:	\$ 7,149,595
Southwest Transmission Cooperative, Inc.:	<u>\$14,360,920</u>
	\$21,510,515

The requested allocation is consistent with Decision No. 63305 which found that "The purpose of the proposed loan from RUS-FFB is to finance transmission and generation projects valued at \$14,360,920 and \$7,149,595, respectively." (See Decision No. 63305, Finding of Fact No. 9.)

Staff recommends approval of the request to amend Decision No. 63305 and the applicants' request for authority to issue debt.

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Summary

AEPCO and Southwest Transmission, Inc. (the "Applicants") request authority to issue debt previously granted AEPCO prior to its restructuring. AEPCO was restructured into three companies pursuant to Decision No. 63868. Staff recommends approval and it views that such approval should have been requested and granted at the time of the restructuring. The request to transfer AEPCO's existing debt authorization to Southwest Transmission Cooperative, Inc. ("Southwest") is consistent with Decision No. 63868 because that Decision transferred AEPCO's transmission assets to Southwest.

Discussion

On March 20, 2002, AEPCO and Southwest requested authority to amend Commission Decision No. 63305. That Decision, dated January 11, 2001, granted AEPCO authority to issue up to \$21,510,515 from the Rural Utilities Service-Federal Financing Bank ("RUS-FFB"). Subsequently, AEPCO was restructured into three affiliated entities pursuant to Decision No. 63868 dated July 25, 2001: AEPCO, Southwest, and Sierra Southwest Cooperative Services, Inc. Unfortunately, that restructuring authority did not transfer and divide AEPCO's existing financing authority among the three affiliated entities.

Subsequently, the Applicants refiled their request under a new matter number as action had not been taken on the issue because of procedural issues. The Applicants expressed an immediate need for the authority because debt agreements with the RUS-FFB to finance transmission assets are on the verge of expiration.

AEPCO and Southwest now request that the financing authority granted the pre-restructured AEPCO in Decision No. 63305 be transferred to the post-restructured AEPCO and Southwest in the following manner:

AEPCO:	\$ 7,149,595
Southwest Transmission Cooperative, Inc.:	<u>\$14,360,920</u>
	\$21,510,515

The requested allocation is consistent with Decision No. 63305 which found that "The purpose of the proposed loan from RUS-FFB is to finance transmission and generation projects valued at \$14,360,920 and \$7,149,595, respectively." (See Decision No. 63305, Finding of Fact No. 9.)

Staff views the Applicants' request as primarily an administrative matter that should have been made and granted pursuant to the restructuring order, Decision No. 63868.

Financial Analysis

The Applicants currently have applications before the Commission to issue debt for projects other than the projects discussed in Decision No. 63305. Staff's analysis and reports for those applications are still in progress. *Preliminarily*, the financial analysis for AEPCO appears to result in a post-debt times interest earned ratio ("TIER") and debt service coverage ratio ("DSC") above 1.0. The preliminary results for Southwest appear to indicate a TIER of 1.74 and DSC of .96. However, Southwest only has five months of results through 2001 because it is a new entity, so Staff could not perform a standard pro-forma analysis based on actual results for a full year. Rather, Staff annualized five months of actual results. Southwest's financial forecasts for 2003 indicate a TIER of 1.26 and a DSC of 1.0, and its forecasts for 2004-2011 indicate generally increasing TIER ratios. Staff's analysis of Southwest's financial forecasts indicates an equity capitalization of 5.95 percent in 2003 and steady improvement through 2011 at 28.7 percent.

The RUS requires that the average coverage ratios achieved by a borrower in the two best years out of the three most recent calendar years must meet certain minimums. For distribution borrowers those ratios are a TIER of 1.5 and a DSC of 1.25. The minimum coverage ratios required of power supply borrowers are a TIER of 1.05 and a DSC of 1.00. The RUS also has forward-looking ratio requirements and can restrict funds as it feels appropriate based on financial performance criteria. (*See* Code of Federal Regulations §1710.114.¹)

Staff has been concerned with AEPCO's ability to incur additional debt. Southwest Transmission Cooperative, Inc. shares financial management with AEPCO, being an affiliated interest, and Staff has the same concerns about Southwest Transmission Cooperative, Inc. In Decision No. 64227, dated November 29, 2001, the Commission authorized AEPCO to incur \$23,700,000 in intermediate-term debt and \$30,000,000 in long-term debt to refinance the \$23,700,000. In that docket, Staff recommended that as a condition of approval, AEPCO be required to file a capital plan to increase its membership capital (equity) position to 10 percent by December 31, 2006, to 15 percent by the end of 2010, and to 30 percent by the end of 2015. That plan was to be filed by December 31, 2002. The Commission adopted Staff's recommendation in Decision No. 64227.

Staff Recommendations

Staff recommends that the Commission approve the application, subject to the condition that Southwest Transmission Cooperative, Inc. be required to file a capital plan to increase its membership capital (equity) position to 10 percent by December 31, 2006, to 15 percent by the end of 2010, and to 30 percent by the end of 2015. This condition is the same as the condition imposed on AEPCO. The plan should be filed by December 31, 2002, consistent with the AEPCO capital plan's filing.

¹ CFRs can be obtained through <http://www.access.gpo.gov/nara/cfr/index.html#page1>.

Staff largely views this application as an administrative matter resulting from the restructuring, rather than as a traditional financing application. Nevertheless, Staff views the condition requiring Southwest Transmission Cooperative, Inc., to file a capital plan as prudent.

Such approval would authorize AEPCO to issue debt up to \$7,149,595 for generation and Southwest Transmission Cooperative, Inc. to issue debt up to \$14,360,920 for transmission, the \$21,510,515 total originally authorized in Decision No. 63305.

Decision No. 63305 Attachment

BEFORE THE ARIZONA CORPORATION COMMISSION
DOCKETED

WILLIAM A. MUNDELL
CHAIRMAN
JIM IRVIN
COMMISSIONER
MARC SPITZER
COMMISSIONER

JAN 11 2001

DOCKETED BY

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IN THE MATTER OF THE APPLICATION OF
ARIZONA ELECTRIC POWER COOPERATIVE,
INC'S REQUEST FOR AUTHORIZATION TO
INCUR LONG-TERM DEBT

DOCKET NO. E-01773A-00-0227

DECISION NO. 63305

ORDER

Open Meeting
January 9 and 10, 2001
Phoenix, Arizona

BY THE COMMISSION:

On April 7, 2000, Arizona Electric Power Cooperative, Inc. ("AEPCO" or "Cooperative") filed with the Arizona Corporation Commission ("Commission") an application requesting approval of \$21,510,515 in long-term debt. On November 17, 2000, the Commission's Utilities Division Staff ("Staff") filed a Staff Report, in which it recommended approval of the application without a hearing.

AEPCO has provided adequate notice of the application and filed a letter with the Commission on December 13, 2000 verifying such notice had been provided

* * * * *

Having considered the entire record herein and being fully advised in the premises, the Commission finds, concludes, and orders that:

FINDINGS OF FACT

1. AEPCO is a Class A¹ non-profit electric generation and transmission cooperative located in Benson, Arizona.

2. AEPCO provides wholesale electricity to six Class A member cooperatives², two Class B members³, and one Class C member⁴ (collectively "Members"). AEPCO's members are located in Arizona and parts of New Mexico and California.

¹ Based on information contained in AEPCO's 1999 Annual Report to the Commission, the Applicant's total operating revenues were \$163,141,948.

1 3. Through the Cooperative's Members, AEPCO provides electrical power to
2 approximately 105,000 residential and business customers in the three-state area at rates and charges
3 approved by Commission Decision No. 58405 (September 3, 1993).

4 4. On April 7, 2000, AEPCO filed an application with the Commission requesting
5 approval of \$21,510,515 in long term debt through the Rural Utilities Service ("RUS")- Federal
6 Financing Bank ("FFB") guaranteed loan program. The actual interest rate will not be known until
7 the loan contract between RUS-FFB and AEPCO is finalized, so only an estimate of the actual annual
8 fiscal impact on the Cooperative can be made. According to the RUS, loans are presently being made
9 at an interest rate of 6.22 percent.

10 5. AEPCO has estimated that its loan will be in the form of fixed rate notes with an
11 interest rate of 6.25 percent based on an analysis of current yield curves.

12 6. Staff calculations determined that the annual debt service associated with the loan will
13 range from \$1,849,299 to \$1,924,520, based on interest rate of 6.00 and 6.50 percent, respectively.

14 7. On November 17, 2000, Staff filed its Staff Report in this matter.

15 8. AEPCO has provided notice of the application to its Members and subsequently filed a
16 letter with the Commission on December 13, 2000 verifying such notice had been provided.

17 9. The purpose of the proposed loan from the RUS-FFB is to finance transmission and
18 generation projects valued at \$14,360,920 and \$7,149,595, respectively.

19 10. The transmission project includes transmission lines valued at a cost of \$944,160, new
20 substations and switching stations totaling \$5,775,385, line and station changes totaling \$4,052,197,
21 other transmission items totaling \$1,971,746, and ordinary replacements on lines and substations
22 totaling \$1,617,432.

23
24
25 ² AEPCO's Class A members include Duncan Valley Electric Cooperative, Graham County Electric Cooperative,
Sulphur Springs Valley Electric Cooperative, Trico Electric Cooperative, Mohave Electric and Anza Electric.

26 ³ AEPCO's Class B members are comprised of the City of Mesa Electric Utility, and Morenci Water and Electric
27 Company.

28 ⁴ AEPCO's Class C member is Salt River Project, which signed a 20-year 100 megawatt firm power contract in
1988.

1 11. The generation project will include new and replacement generation assets including a
2 cooling tower, various types of scrubbers, a generator relay, and a coal loader for a total cost of
3 \$7,149,595.

4 12. Staff Engineering has reviewed the projects and cost estimates and found them to be
5 reasonable and appropriate.

6 13. As of December 31, 1999, AEPCO had long-term debt of \$318,505,317. Also during
7 this operating period, AEPCO's financial statements indicate negative equity of \$4,099,373, resulting
8 in 101.3 percent debt and negative equity of 1.3 percent.

9 14. Based on the Applicant's December 31, 1999 financial information, the pro forma
10 effect of the loan will result in AEPCO having a TIER of 1.21 and DSC of 0.94⁵. Staff stated in its
11 Report that although the ratios would indicate a less than satisfactory ability to maintain debt service
12 coverage, Staff believes that AEPCO's past performance proves otherwise. Staff observed during
13 operating periods from 1991 through 1999, that AEPCO was able to handle an even larger amount of
14 long-term debt with lower TIER and DSC ratios during a previous operating year.⁶

15 15. AEPCO's balance sheet for 1999 reflected that the Cooperative had unrestricted cash
16 and cash equivalents of \$15,490,868 or approximately 8.05 times the amount of increased debt
17 service that the Cooperative would be obligated to pay if the proposed loan were approved at an
18 interest rate of 6.5 percent.

19 16. Staff believes that, based on the information contained in AEPCO's balance sheet, that
20 the Cooperative has the ability to meet its debt obligations despite the lower TIER and DSC ratios.

21 17. Staff's analysis indicated that AEPCO's capital structure after the proposed loan will
22 result in 101.2 percent debt and negative equity of 1.2 percent, regardless of the interest rate that
23 AEPCO obtains for the proposed loan.

24
25
26 ⁵ Times Interest Earned Ratio ("TIER") and Debt Service Coverage ("DSC") are indices of an entity's ability to
27 make interest payments and interest and principal payments on debt, respectively. A TIER of 1.50 and DSC of 1.25 are
generally preferred. According to CFR 1710, AEPCO is required to have a TIER of 1.05 and DSC of 1.0.

28 ⁶ During the period ending December 31, 1995, AEPCO had long-term debt of \$369,066,271. The Cooperative's
TIER and DSC ratios for the same period were 0.85 and 0.79 respectively.

18. Staff stated in its Report that AEPCO's negative equity position resulted primarily from write-offs in 1987 of certain deferrals, in addition to the loss of Members' high demand customers in the late 1980's and early 1990's. The negative equity has declined from negative equity of \$49.4 million in 1992, to the current level of negative \$4.1 million.

19. According to Staff, the decrease in the negative equity is largely attributed to improved retained earnings, resulting from positive net margins realized during 1991 to 1994 and 1996 to 1999. Furthermore, AEPCO's negative equity position has never significantly impeded the Cooperative's access to debt financing. Staff believes that AEPCO's current negative equity position should not prevent approval of the proposed debt.

20. Staff concluded that the proposed financing is for lawful purposes, consistent with sound financial practices, and is in the public interest. Staff recommended approval of the application without a hearing.

CONCLUSIONS OF LAW

1. AEPCO is a public service corporation within the meaning of Article XV of the Arizona Constitution and A.R.S. §§ 40-301 and 40-302.

2. The Commission has jurisdiction over AEPCO and the subject matter of the application.

3. Notice of the application was given in accordance with the law.

4. The financing approved herein is for lawful purposes, within AEPCO's corporate powers, is compatible with the public interest, with sound financial practices, with the proper performance by AEPCO of service as a public service corporation, and will not impair AEPCO's ability to perform that service.

5. The financing approved herein is for the purposes stated in the application and is reasonably necessary for those purposes, and such purposes are not, wholly or in part, reasonably chargeable to operating expenses or to income.

6. Staff's recommendation set forth in Findings of Fact No. 20 is reasonable and should be adopted.

ORDER

IT IS THEREFORE ORDERED that Arizona Electric Power Cooperative, Inc. is hereby authorized to borrow up to \$21,510,515 from the Rural Utilities Service-Federal Financing Bank for a term of up to 20 years at an interest rates then prevailing. The actual interest rate to be applied to the loan will be determined at the time of the financial transaction.

IT IS FURTHER ORDERED that Arizona Electric Power Cooperative, Inc. is hereby authorized to engage in any transactions and to execute any documents necessary to effectuate the authorization granted above.

IT IS FURTHER ORDERED that Arizona Electric Power Cooperative, Inc. shall file a copy of all executed loan documents with the compliance section of the Utilities Division within 30 days of obtaining such financing.

IT IS FURTHER ORDERED that such authority shall be expressly contingent upon Arizona Electric Power Cooperative, Inc.'s use of the proceeds for the purposes set forth in the application.

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1 IT IS FURTHER ORDERED that approval of the financing set forth above does not
2 constitute or imply approval or disapproval by the Commission of any particular expenditure of the
3 proceeds derived thereby for purposes of establishing just and reasonable rates.

4 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

5 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

6
7
8 CHAIRMAN

COMMISSIONER

COMMISSIONER

9
10
11 IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive
12 Secretary of the Arizona Corporation Commission, have
13 hereunto set my hand and caused the official seal of the
14 Commission to be affixed at the Capitol, in the City of Phoenix,
15 this 14 day of January, 2001.

16
17 BRIAN C. McNEIL
18 EXECUTIVE SECRETARY

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DISSENT _____
AG:bbs

Decision No. 63868 Attachment

BEFORE THE ARIZONA CORPORATION COMMISSION
DOCKETED

JUL 25 2001

WILLIAM A. MUNDELL
Chairman
JIM IRVIN
Commissioner
MARC SPITZER
Commissioner

DOCKETED BY

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IN THE MATTER OF THE APPLICATION
OF THE ARIZONA ELECTRIC POWER
COOPERATIVE, INC., FOR VARIOUS
AUTHORIZATIONS ASSOCIATED WITH ITS
RESTRUCTURING

DOCKET NO. E-01773A-00-0826

DECISION NO. 63868

ORDER

Open Meeting
July 24 and 25, 2001
Phoenix, Arizona

FINDINGS OF FACT

1. On October 11, 2000, Arizona Electric Power Cooperative, Inc. ("AEPCO" or "the Cooperative") filed an application for approval and confirmation of various transactions enabling the Cooperative's restructuring into three affiliated entities. The approvals and confirmations requested include:

- A.) Approval of the transfer of AEPCO's transmission assets to Southwest Transmission Cooperative Inc. ("Southwest") and approval of the transfer of its cooperative service provider business to Sierra Southwest Cooperative Services, Inc. ("Sierra").
- B.) Approval of AEPCO and Southwest to execute notes, mortgages and assumption and indemnity agreements associated with the restructuring.
- C.) Approval of a partial requirements relationship between AEPCO and Mohave.
- D.) Approval of the revised Class A member unbundled tariff and the forgiveness of the Purchased Power and Fuel Adjustment Clause.
- E.) Confirmation that AEPCO has complied with the requirements of A.C.C. R14-2-1615 by this restructuring.
- F.) Approval of waivers or, alternatively, approval of AEPCO's Code of Conduct.
- G.) Confirmation that the financial commitment conditions of Decision No. 61932 pertaining to Sierra have been satisfied.

1 H.) Authorization of AEPCO, Southwest Transmission and Sierra to engage in any
2 transactions and to execute any documents necessary to effectuate these authorization
3 and complete the restructuring.

4 2. The initial application requested approval of revised rates that resulted in a rate
5 decrease to AEPCO's members of 3.05 percent.

6 3. On April 11, 2001, AEPCO amended the application and eliminated the rate reduction
7 proposed in the original application and proposed revised unbundled rates calculated to have no effect
8 on AEPCO's revenues. AEPCO submitted rate base and other financial information as Exhibit C to
9 the Amended Application demonstrating that the proposed rates would produce a rate of return of 7.35
10 percent on its total original cost/fair value rate base of \$260,436,970.

10 Background

11 4. AEPCO is a non-profit Arizona rural electric generation and transmission cooperative
12 primarily engaged in the generation, transmission, purchase, and sale of electricity at wholesale.
13 AEPCO supplies all of the electric power requirements of its six Class A member-owned, not-for-
14 profit distribution cooperatives ("Class A Members") under full requirement capacity and energy
15 contracts. These members are Anza Electric Cooperative, Inc. (located entirely in California), Duncan
16 Valley Electric Cooperative, Inc. (partially located in New Mexico), Graham County Electric
17 Cooperative, Inc., Sulphur Springs Valley Electric Cooperative, Inc., Trico Electric Cooperative, Inc.,
18 and Mohave Electric Cooperative, Inc. ("Mohave"). These cooperatives serve a combined customer
19 base of 114,720.

20 The Restructuring

21 5. AEPCO proposed to restructure into Southwest, Sierra and a restructured AEPCO.

22 A) Sierra, which already holds a CC&N as an Arizona Electric Service Provider, will
23 market power, provide staffing and other resources to Southwest and AEPCO and
24 will sell other electricity-related services.

25 B) AEPCO will be a generation cooperative that also acts as a power trader for short-
26 term power.

27 C) Southwest will own and operate all of AEPCO's transmission.
28 ...

1 6. AEPCO submitted a Study Committee Report on the Restructuring that outlined the
2 purposes for restructuring which include: to increase competitiveness of AEPCO and its members;
3 create efficiencies; make available more flexible power purchases arrangements to AEPCO's members;
4 and to diminish regulatory burdens.

5 7. The necessary agreements and contracts to implement the restructuring have taken over
6 five years to prepare and coordinate, and has cost approximately \$2.4 million for outside counsel and
7 consulting fees, internal meetings, travel and other costs related to the restructuring.

8 8. AEPCO has agreed that the restructuring will not alter the existing jurisdiction of either
9 this Commission or the Federal Energy Regulatory Commission ("FERC") over AEPCO and
10 Southwest or over their generation and transmission rates.

11 9. AEPCO's application requested that the Commission approve a tariff for AEPCO that
12 will pass through Southwest's FERC approved OATT charges to its member cooperatives. AEPCO
13 agreed that this Commission has jurisdiction over the tariff.

14 10. Southwest will finance the purchase of the transmission assets by assuming \$96.2
15 million of existing AEPCO debt. Southwest will assume \$66.1 million of RUS debt and guaranteed
16 debt and will enter into assumption and indemnity agreements as to the balance of the assumed debt
17 with other AEPCO lenders. These amounts are subject to adjustment at closing based on the final
18 appraisal and AEPCO's financial statements at that time.

19 11. AEPCO's Class A members, along with AEPCO and Sierra, will all become members
20 of Southwest. Southwest will be a non-taxable cooperative, subject to the annual member income
21 qualifications under IRS Code Section 501c(12).

22 12. AEPCO will retain the generating assets and will continue to provide electric capacity
23 and energy to its members, and others, using its generating units along with purchased power. Power
24 trading, power billing and scheduling will be performed by AEPCO.

25 13. AEPCO will obtain transmission services from Southwest under Southwest's Open
26 Access Transmission Tariff ("OATT") in order to continue to make bundled sales to its Class A all
27 requirements members, SRP, Mesa, ED2 and MW&E and other third-party sales. When AEPCO
28 makes a bundled sale, AEPCO will acquire transmission from Southwest or others, as needed. When

1 AEPCO makes an unbundled sale to other parties, the customer will be responsible for obtaining
2 transmission whether from Southwest or other transmission providers.

3 14. AEPCO will remain a non-taxable cooperative, subject to the annual member income
4 qualifications under IRS Code Section 501c(12). The income qualification is that at least 85 percent
5 of its gross income will be "related income" from its members.

6 15. On August 27, 1999, the Commission issued Decision No. 61932, which granted Sierra
7 a Certificate of Convenience and Necessity ("CC&N") to operate as an electric service provider and
8 authorized Sierra to supply competitive retail electric services as a load-serving entity and as an
9 aggregator in all areas of the State of Arizona which are opened to retail electric competition. The
10 Decision also authorized Sierra to resell meter service and meter reading service.

11 16. This application also requests approval to transfer various non-generation and non-
12 transmission AEPCO assets (primarily financial assets) from AEPCO to Sierra. Sierra will provide
13 support services for AEPCO and Southwest. This support includes management of improvements and
14 additions to facilities, employee development, contracting and subcontracting, warehousing, inventory
15 control, fuel procurement, environmental permitting, engineering services, financial and accounting
16 services, budgeting, forecasting planning and scheduling, media and public relations and legal services.

17 17. Sierra also intends to offer energy-related products such as distributed generation
18 equipment, energy management, power quality solutions, facility operations and maintenance service,
19 consolidated billing and other services.

20 18. Sierra will also engage in competitive retail electric sales activities and will function
21 as a power marketer for wholesale power sales and load aggregation. However, pursuant to
22 Commission rules, Sierra cannot offer competitive service in the Class A member distribution
23 cooperatives' service area until the Commission has deemed those areas open to competition.

24 19. Sierra will be a taxable cooperative because, initially, the bulk of its income will come
25 from its staffing services rather than the sale of electricity.

26 20. The application requested approval to transfer the transmission portion of AEPCO's
27 CC&N to Southwest. After closing, Southwest will immediately generate revenues from AEPCO's
28 Class A members and others. The employees who will operate Southwest's transmission system are

1 currently the AEPCO employees who operate the same transmission system. For these reasons, Staff
2 believes that Southwest is a fit and proper entity to receive the transmission portion of AEPCO's assets
3 and CC&N and recommends that the Commission approve the transfer.

4 Financing Issues

5 21. AEPCO's financial health has steadily improved since 1995. Except for the \$6.7
6 million write-off of the PPFAC bank balance and \$4.1 million shortfall charge-back expense related
7 to sales to California, AEPCO's net margins (equivalent to net profit for an investor-owned utility) in
8 2000 would have been the highest in six years. Long-term debt has steadily declined, while
9 membership capital (equivalent to "common equity" for investor-owned utilities) steadily increased
10 and turned positive in 2000 for the first time in many years. Interest expense has also steadily declined
11 over the six years. The balance of AEPCO's Cash and Cash Equivalents account, which represents
12 cash and investments that are readily converted to cash, was \$49.0 million at December 31, 2000.

13 22. The application also requested approval for AEPCO and Southwest to execute notes,
14 mortgages and assumption and indemnity agreements associated with the restructuring. These will
15 be necessary for the transfer of some of AEPCO's debt to Southwest.

16 23. Any debt assumed by or transferred to Southwest from AEPCO will be issued at
17 identical interest rates and maturities as the debt presently carries. Because the amount of debt to be
18 assumed or replaced by Southwest will not be known precisely until the close of the transaction, the
19 Cooperatives have requested that approval for Southwest to execute notes, mortgages and assumption
20 and indemnity agreements be for a total amount of up to \$100.0 million. Also, AEPCO will need
21 approval to issue replacement notes for the debt that it is retaining.

22 24. None of the debt for which approval is requested is "new" debt. The total will sum to
23 AEPCO's debt immediately before closing. Staff believes that these debt transactions are necessary
24 to effectuate the restructuring. Because Southwest's transmission rates and AEPCO's rates for
25 generation are set to equal their revenue requirement and the debt service related to the assumed debt
26 is part of that revenue requirement, Southwest and AEPCO should have the ability to make principal
27 and interest payments on the assumed debt. If the restructuring is approved, Staff recommended
28 ...

1 approval for AEPCO and Southwest to execute notes, mortgages and assumption and indemnity
2 agreements in an amount not to exceed AEPCO's debt immediately before closing.

3 25. AEPCO and Southwest will make cash capital contributions to Sierra in the amount of
4 \$4.0 million to enable its formation. Because substantially all of AEPCO's assets are subject to the
5 Rural Utility Services ("RUS") and the National Rural Utilities Cooperative Finance Corporation
6 ("CFC") mortgage, AEPCO is seeking a release of the Sierra business and assets from the mortgage.

7 26. The Restructuring Agreement executed by AEPCO, Southwest and Sierra provides that
8 Sierra will be financed through capital contributions of \$4.0 million from Southwest and AEPCO.
9 Sierra has also applied for credit support in the amount of \$500,000 from the National Rural Utilities
10 Cooperative Finance Corporation ("CFC"). The funds from AEPCO, Southwest and the CFC will be
11 used primarily to cover a thirty to forty-five day lag between the generation of revenue and the
12 payment of payroll. These capital contributions and credit support fulfill Sierra's financial information
13 compliance condition of Decision No. 61932.

14 27. AEPCO currently has a balance of approximately \$200.0 million in RUS and RUS
15 guaranteed debt. It also has debt outstanding to other lenders including the CFC. To protect its
16 interests in being repaid in a timely manner, the RUS imposed restrictions that AEPCO and Southwest
17 must follow in the restructuring. One condition is the retention by AEPCO of the existing bundled
18 sales contracts between AEPCO and the Class A all-requirements members.

19 28. The RUS also limited Sierra's control over the activities of AEPCO and Southwest
20 because RUS will have no control over Sierra. The purpose of this restriction is to ensure that AEPCO
21 and Southwest's margins are not appropriated by Sierra compromising their ability to make timely debt
22 payments to RUS.

23 29. Final RUS approval of the notes and replacement debt will occur after AEPCO and
24 Southwest have received Commission approval of the restructuring of AEPCO.

25 FERC

26 30. On April 11, 2001, Sierra and Southwest filed an application with FERC relating to the
27 restructuring of AEPCO. Sierra requested FERC authorization of a rate schedule for the wholesale
28 sale of electric energy and capacity at market-based rates and for authorization for the Resource

1 Integration Agreement which governs some of Sierra's wholesale power sales. Sierra also requested
2 that FERC issue a declaratory order disclaiming jurisdiction over AEPCO and Southwest because they
3 have RUS and RUS guaranteed debt and Sierra will not have operational control over either AEPCO
4 or Southwest. Southwest requested that FERC make a finding that Southwest's Open Access
5 Transmission Tariff is an acceptable reciprocity tariff and that its proposed Standards of Conduct
6 satisfy the standards required by FERC Order No. 889. On May 30, 2001, without a hearing or
7 suspension, FERC issued an order approving Sierra's and Southwest's applications.

8 Code of Conduct

9 31. AEPCO has requested approval of a Code of Conduct between itself and Sierra and
10 between the Class A members and Sierra. These Codes of Conduct were submitted to comply with
11 A.A.C. R14-2-1616. However, AEPCO contends that the Code of Conduct rules do not apply and,
12 therefore, AEPCO requested waivers from these rules or, in the alternative, approval of the Codes of
13 Conduct as proposed.

14 32. Although the three entities will have separate functions and each will have its own
15 Board of Directors, the Boards will primarily be chosen from the same pool of individuals from which
16 AEPCO's current directors originate.

17 33. In the restructured company, Sierra will perform several roles, which includes an
18 overlap of roles in both the wholesale and retail markets. However, Sierra's role as a wholesale and
19 retail marketer are not addressed in the proposed Codes of Conduct.

20 34. The market power study submitted to FERC by Southwest and Sierra reports that Sierra
21 will provide personnel to fill non-core positions at AEPCO and Southwest. Staffing agreements will
22 govern the functions of and payments for these employees. AEPCO and Southwest will provide
23 management directives, policies, and supervision of Sierra's employees. The Sierra employees
24 assigned to Southwest will be subject to the OASIS Standards of Conduct. Thus, structurally, Sierra
25 employees will not have operational control over the activities of AEPCO or Southwest.

26 35. Sierra, as an electric service provider, will work in conjunction with the member
27 distribution cooperatives, which are rate regulated utilities, through a Joint Marketing Agreement. For
28 the other utilities in the state, a separation of the competitive provider and the utility is required.

1 AEPCO contends that if it can not offer the competitive services through this arrangement, the services
2 will likely not be provided at all in the rural regions of the state.

3 36. AEPCO has asserted that it and Southwest will comply with the FERC's rules,
4 procedures and guidelines concerning the separation of the merchant and power marketing functions
5 of an electric utility from its transmission functions and that appropriate standards of conduct will be
6 followed to ensure adequate separation. AEPCO contends that the member owned corporate structure
7 of the cooperatives minimizes Code of Conduct concerns because any margins in either market will
8 accrue to the members.

9 37. AEPCO, Southwest and Sierra and the member distribution cooperatives are member
10 owned and they serve a region of the state that would likely not be profitable enough for others to
11 service is a factor in Staff's recommendation that the Commission approve the Code of Conduct at this
12 initial stage.

13 38. Staff also recommended that the Commission reserve the right to impose additional
14 restrictions if problems arise or if the demand for competitive services becomes larger than anticipated
15 and would support other service providers in the rural regions of the state.

16 39. These issues according to Staff should be re-examined in AEPCO's and Southwest's
17 next rate case.

18 Partial Requirement Contract

19 40. AEPCO has also requested the approval of a Partial Requirement Capacity and Energy
20 Agreement with Mohave. As part of the restructuring, Mohave, AEPCO's largest Class A member,
21 would convert from a full requirement member to a partial-requirement member.

22 41. Mohave would pay for electric service based upon a three-part charge, consisting of a
23 fixed charge, charges based on an Operations and Maintenance rate and an energy rate charge. The
24 fixed charge represents Mohave's share of AEPCO's debt payments and is instrumental in receiving
25 RUS approval.

26 42. The restructuring will also provide the five remaining Class A, full requirement
27 members the opportunity to seek to become partial requirements customers in the future pursuant to
28 separate conversion agreements that would be subject to approval of the RUS.

1 43. AEPCO will supply Mohave power and energy based on its historic demand and
2 investment. However, Mohave will be free to procure its additional needs from other sources.

3 44. Because Mohave will only participate in the wholesale market for its incremental
4 needs, the recent volatility in electric prices should present a minimal risk. In return, the partial
5 requirement arrangement provides Mohave the opportunity to pursue advantageous pricing
6 arrangements as the wholesale market matures and becomes less volatile and chaotic. Therefore, the
7 Partial Requirements Capacity and Energy Agreement should be approved.

8 Purchased Power and Fuel Adjustor Clause

9 45. The fundamental rationale for a fuel adjustment clause is that fuel prices can change
10 radically based on the overall energy market. During much of the time that AEPCO's restructuring
11 was being planned, fuel prices were dropping. During the more recent past, there has been a dramatic
12 reversal of that trend. It is likely that for at least the near future, energy prices will be unstable.

13 46. Purchased power and fuel adjustor clauses for Arizona utilities may be created and set
14 during a rate case wherein a base cost of fuel and purchased power is determined and included in base
15 rates. The base period cost of fuel and purchased power adopted in AEPCO's last rate case and used
16 in the subsequent fuel adjustor filings is \$0.01714 per kWh. AEPCO's most recent filing of its fuel
17 and purchased power cost adjustment indicated that its current cost of fuel and purchased power is
18 \$0.026034.

19 47. AEPCO's application requested the Commission's approval to: (1) forgive the under-
20 collected balance in its PPFAC bank as of the effective date of the restructuring and (2) to eliminate
21 its PPFAC on an on-going basis.

22 48. As of December 31, 2000 AEPCO's PPFAC bank balance was undercollected by
23 approximately \$6.7 million. Between January 1 and March 31, 2001, AEPCO has accumulated an
24 additional undercollected balance of \$2.3 million.

25 49. Staff has not audited the cumulative expenses included in AEPCO's reported
26 undercollected PPFAC balance in several years. Staff cannot confirm the amount undercollected
27 without a complete audit of the historical PPFAC filings, accounting and related invoices.

28 ...

1 50. Staff has recommended that the Commission approve, nunc pro tunc, the write-off of
2 the December 31, 2000 PPFAC, undercollected balance of \$6.7 million.

3 51. Staff also recommended that the Commission order that a new docket be opened in
4 which to examine the PPFAC. Within the docket, Staff would perform an audit of the PPFAC filings
5 to verify the balance and to verify AEPCO's compliance with previous Commission orders. Staff
6 would make recommendations to the Commission as to the appropriate amount of the write-off and
7 whether the adjustor should be continued or eliminated.

8 Rates

9 52. AEPCO also requested approval of rates for its Class A members. AEPCO's current
10 rates to its Class A members were set by Decision No. 58405, dated September 3, 1993. The rates set
11 were bundled rates of \$15.25 per kW of billing demand plus \$0.0228 per kWh. AEPCO's original
12 restructuring application requested approval of a tariff that represented a rate reduction to its Class A
13 members. AEPCO's amended application requested approval of a tariff that was designed to result in
14 no change in the Class A members' total power bills.

15 53. AEPCO's amended application also requested that the rates for generation charged to
16 its all requirements Class A members be set at \$12.44 per kW of billing demand plus \$0.01989 per
17 kWh. Southwest's rates for transmission for Class A members and for all other parties are set forth
18 in its Open Access Transmission Tariff ("OATT"), which has already received FERC approval. The
19 OATT rates include a monthly demand charge determined by multiplying the proportion of the
20 customer's load to Southwest's load by one-twelfth of Southwest's annual revenue requirement. The
21 rate setting methodology is set forth in the transmission agreements between AEPCO and Southwest
22 and Mohave and Southwest. According to the OATT, Southwest's revenue requirement for network
23 integration transmission service is \$13.4 million, "effective until amended by Southwest." This
24 translates into initial transmission rates of \$3.244 per kW per month.

25 54. Although the total of the generation and transmission demand rates of \$12.44 and
26 \$3.244, respectively, equals \$15.684 per kW and exceeds the bundled demand rate of \$15.25 per kW,
27 the new kWh charge of \$0.01989 is less than the bundled kWh charge of \$0.0228. When the
28 unbundled rates are applied to the Class A members' bills for the twelve months ending December 31,

1 2000, the resulting pro forma power bills were \$1.0 million less than the actual total power bills during
2 2000. On an individual basis, the pro forma power bills of the Class A members all were less than
3 their actual bills. Thus, the impact on all of the Class A members, all factors held constant, should be
4 that their power bills will be slightly lower than they would have been under the old, bundled rates.

5 Future Rate Case

6 55. Although AEPCO expects some cost savings through Sierra's provision of centralized
7 services, some costs may increase under the proposed restructured organization. The cost of the
8 reorganization itself and the costs of educating, transporting and housing three Boards of Directors are
9 costs that may increase.

10 56. Decision No. 58405 required AEPCO to conduct a fully allocated embedded cost of
11 service study in conjunction with its next rate filing.

12 57. Staff has recommended that the Commission order AEPCO and Southwest to each file
13 a rate case eighteen months after the closing of the restructuring for the following reasons: to insure
14 that asset and liability allocations among the three entities have been performed in a fair and equitable
15 manner; to insure that the ultimate customers of AEPCO benefit from any cost savings from the
16 restructuring; to insure that AEPCO's and Southwest's rates are fair and reasonable; to determine if the
17 allocations among the three entities were reasonable; and to determine if the restructured cooperatives
18 were experiencing savings from the restructuring that exceed the costs.

19 58. A rate case that would be filed 18 months after the restructure has occurred would
20 encompass one year of operations under the new structures and provide the cooperatives an appropriate
21 amount of time to close the books and to prepare a rate case submission.

22 Notice

23 59. AEPCO's member cooperatives have received notice and agree to AEPCO's
24 application.

25 60. AEPCO published notice of the Application in the Daily Star and in Kingman and
26 Sierra Vista newspapers.

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1 Recommendations

2 61. Staff recommended approval of the restructuring and the transactions to effectuate the
3 restructuring. However, because of the many issues raised by this application and the volatility of the
4 energy market, there are several conditions that should be attached to the Decision in this matter.

5 62. Staff recommended approval of the forgiveness of the December 31, 2000
6 undercollected PPFAC balance. However, Staff also recommended that the Commission authorize
7 Staff to open a docket and request a procedural order be issued within 90 days from the decision in this
8 docket. The purpose of the docket would be to examine AEPCO's PPFAC. Staff would perform an
9 audit of AEPCO's PPFAC filings and balance to verify the balance and verify AEPCO's compliance
10 with previous Commission orders. At that time Staff will also make a recommendation regarding the
11 continuation or discontinuation of the PPFAC and a recommendation regarding the balance forgiven.

12 63. Staff recommended that the Commission order that both the new AEPCO and
13 Southwest file rate cases eighteen months from the closing of the restructuring. In the rate
14 applications, AEPCO and Southwest should include an analysis of the savings and benefits enjoyed
15 from the formation of Sierra that would not have been experienced without the restructuring and
16 include a cost of service study as ordered by Decision No. 58405.

17 64. Staff recommended that the Commission approve the codes of Conduct attached as
18 Exhibit D to the Application but reserve the right to impose additional restrictions on Sierra at the time
19 of AEPCO and Southwest's next rate case if problems arise regarding Sierra's role as a wholesale
20 purchaser and a cooperative service provider, or if the demand for competitive services becomes larger
21 than anticipated and would support other service providers in the rural regions of the state.

22 65. Staff recommended that the Commission require Southwest to obtain any necessary
23 franchises and file them in this docket when obtained.

24 66. Staff recommended that the Commission find that to the extent A.A.C. R14-2-1615
25 applies to a generation and transmission cooperative, this restructuring complies with that rule.

26 67. Staff recommended approval of the transfer of AEPCO's transmission assets to
27 Southwest and certain assets to Sierra.

28 ...

1 68. Staff recommended approval of the transfer of the transmission portion of AEPCO's
2 CC&N to Southwest.

3 69. Staff recommended approval of the execution by AEPCO and Southwest of notes,
4 mortgages and assumption and indemnity agreements associated with the restructuring, the total not
5 exceeding AEPCO's outstanding debt immediately previous to the time of closing.

6 70. Staff further recommended approval of the partial requirements relationship between
7 AEPCO and Mohave, with the final executed agreement to be filed with the Commission upon
8 completion of the restructuring. Such relationship should not differ materially from that described in
9 the Application and its exhibits and schedules.

10 71. Staff recommended approval of the revised Class A member all requirement tariff
11 attached as Exhibit B to the Amended Application.

12 72. In response to the Staff analysis, AEPCO agreed to most of the Staff recommendations
13 but offered several points of clarification and suggested certain amendments to two of the Staff
14 recommendations.

15 73. As to Staff's rate case filing recommendation in Finding of Fact No. 63, AEPCO noted
16 the following:

17 A.) Although AEPCO and its members do expect efficiencies and other advantages
18 from the restructuring as summarized at pages 5-6 of its Application, these
19 benefits are primarily qualitative or unrelated to immediate direct cost savings
20 and would be difficult to quantify in the savings benefit analysis suggested by
21 Staff. Therefore, if the Commission orders a rate case filing, AEPCO requests
22 that such an analysis not be required as part of it.

23 B.) AEPCO also suggested that if a rate case filing is required, submitting it two
24 years instead of 18 months from the date of closing would allow a full fiscal
25 calendar year to occur and would also allow the rate information to be premised
26 on audited numbers.

27 C.) AEPCO suggested that the Commission not order, as recommended by Staff,
28 a rate case submission in 2003. Citing the expense and considerable
cooperative and regulatory resources involved in such a filing, AEPCO
maintained that there was no demonstrated need for such a requirement and it
was premature and unnecessary.

1 D.) Alternatively, AEPCO suggested that the rate and cost of service study filing
2 requirement instead be an informational submission to the Director of the
3 Utilities Division two years after closing. This would provide Staff with
4 information without prematurely committing this Commission and the
5 cooperatives to a possibly unnecessary rate case.

6 74. Having reviewed the Staff recommendations and AEPCO's response, the Commission
7 finds that the rate case and cost of service study requirement should be an informational submission
8 to the Director of the Utilities Division within 35 months of the date of closing containing no
9 savings/benefit analysis. After review of the information submitted, Staff may forward to the
10 Commission a recommendation on whether to proceed further. If the decision is made to proceed
11 further to a rate case, the burden of proof shall remain with the cooperatives.

12 75. In response to Staff's Code of Conduct recommendations in Finding of Fact No. 64 and
13 its discussion of the subject in Findings of Fact Nos. 31-39, AEPCO noted that all electric service
14 providers will operate in both retail and wholesale markets as will Sierra. As to Staff's stated concerns
15 of Sierra working with member distribution cooperatives, AEPCO noted that the Code of Conduct
16 contains various safeguards to assure that this does not confer a competitive advantage including the
17 requirement that confidential customer information only be released after written customer
18 authorization and be supplied to any other ESP on the same basis as it is provided to Sierra. Finally,
19 AEPCO suggested that while the Commission retains jurisdiction to revisit issues associated with any
20 approved Code of Conduct, that should not be done in the cooperatives rate cases, but rather in a
21 proceeding noticed for that purpose for either AEPCO or the member distribution cooperatives.

22 76. Having reviewed the Staff recommendations and AEPCO's response, the Commission
23 approves the Codes of Conduct attached as Exhibit D to the Application but AEPCO shall file within
24 35 months of closing the restructuring, an assessment of the codes of conduct for Staff's review.

25 CONCLUSIONS OF LAW

26 1. AEPCO is an Arizona public service corporation within the meaning of Article XV,
27 Section 2, of the Arizona Constitution.

28 2. The Commission has jurisdiction over AEPCO and over the subject matter of the
Application.

1 3. The Commission has reviewed the Application, Staff's Memorandum and the Staff
2 Report and has determined that Southwest is a fit and proper entity to purchase AEPCO's assets and
3 receive the transmission portion of AEPCO's CC&N. The Commission has also determined that the
4 transfer of assets from AEPCO to Sierra is in the public interest and the proposed financing
5 transactions are compatible with sound financial practices and are in the public interest. The
6 Commission has also determined that the rates set forth in the tariff filed with the application are just
7 and reasonable.

8 4. The Commission has determined that Staff's recommendations, set forth in Findings
9 of Fact Nos. 61-71, as modified in Findings of Fact Nos. 74 and 76, are in the public interest and
10 should be adopted.

11 ORDER

12 IT IS THEREFORE ORDERED that the Commission hereby approves AEPCO's application
13 consistent with Staff's recommendations listed in Findings of Fact Nos. 61-71, as modified in Findings
14 of Fact Nos. 74 and 76.

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1 IT IS FURTHER ORDERED that AEPCO, Southwest and Sierra are authorized to engage in
2 any transactions and to execute any documents necessary to effectuate these authorizations and
3 complete the restructuring.

4 IT IS FURTHER ORDERED that this Decision shall become effective immediately.


5 BY ORDER OF THE ARIZONA CORPORATION COMMISSION

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7 
8 CHAIRMAN

9 
10 COMMISSIONER

11 COMMISSIONER

12 IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive
13 Secretary of the Arizona Corporation Commission, have
14 hereunto, set my hand and caused the official seal of this
15 Commission to be affixed at the Capitol, in the City of
16 Phoenix, this 25th day of April, 2001.

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18 BRIAN C. McNEIL
19 Executive Secretary

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DISSENT: _____

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Decision No. 63868

1 SERVICE LIST FOR: ARIZONA ELECTRIC POWER COOPERATIVE, INC.
DOCKET NO. E-01773A-00-0826

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Mr. Michael M. Grant
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Phoenix, Arizona 85007

Mr. Steven M. Olea
Acting Director, Utilities Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Decision No. 64227 Attachment

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Johnson

BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission

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WILLIAM A. MUNDELL
CHAIRMAN
JIM IRVIN
COMMISSIONER
MARC SPITZER
COMMISSIONER

Director of Utilities

IN THE MATTER OF THE APPLICATION OF
ARIZONA ELECTRIC POWER COOPERATIVE,
INC. FOR FINANCING APPROVAL.

DOCKET NO. E-01773A-01-0701

DECISION NO. 64227

ORDER

Open Meeting
November 27 and 28, 2001
Phoenix, Arizona

BY THE COMMISSION:

Having considered the entire record herein and being fully advised in the premises, the Commission finds, concludes, and orders that:

FINDINGS OF FACT

1. Arizona Electric Power Cooperative, Inc. ("AEPCO" or "Applicant") is an electric power wholesaler/cooperative that provides power primarily to its Class A, B, and C members.
2. AEPCO had been a non-taxable entity until fiscal year 2000, when its power sales to non-members exceeded fifteen percent of revenues. AEPCO anticipates regaining non-taxable status for fiscal year 2001.
3. On September 4, 2001, AEPCO filed an application seeking authorization to enter into interim and permanent financing arrangements to borrow \$30,000,000 for up to 30 years.
4. The requested funding will be used by AEPCO to finance construction of a new 38 MW gas turbine at the Apache Generation Station near Wilcox, Arizona. The additional electric plant is intended to meet anticipated shortfalls in capacity through 2004.
5. AEPCO contracted with General Electric to purchase the turbine, and expects delivery by May 2002. AEPCO has paid \$6,291,052 from its cash account to General Electric under the agreed upon progress payment schedule.

1 6. The interim financing will be obtained from either the National Rural Utilities
2 Cooperative Finance Corporation ("CFC") and/or the Rural Utilities Service ("RUS"), with an
3 expected financing rate of approximately 6.20 percent. AEPCO expects to obtain the permanent
4 financing from the Rural Utilities Service and the Federal Financing Bank, for a term of 30 years
5 with quarterly debt service payments.

6 7. On November 1, 2001, the Utilities Division Staff ("Staff") filed its Staff Report, and
7 on November 13, 2001, Staff filed its Amended Staff Report.

8 8. Staff's analysis of the proposed financing focused on AEPCO's interest coverage
9 ratios and its capital structure. Staff is concerned that AEPCO is highly leveraged and that this
10 proposed financing will not improve its equity position. AEPCO's pro-forma capital structure for
11 2001 includes member capitalization of 2.1 percent.¹ Although this is an improvement, Staff
12 believes that the equity position is marginal. Staff believes that AEPCO should improve its equity
13 position because currently there is little cushion to offset volatility in fuel costs, non-member energy
14 sales, fuel transportation costs, and purchased power costs. Therefore, Staff recommends that
15 AEPCO be required to submit to the Commission by December 31, 2002, a capital plan to increase its
16 membership capital (equity) position to ten percent by December 31, 2006, to fifteen percent by end
17 of 2010, and to 30 percent by end of 2015.

18 9. Staff also analyzed AEPCO's ability to satisfy current and proposed debt payments.
19 Under previous financings from RUS and the CFC, AEPCO is currently required to maintain a
20 minimum times interest earned ratio ("TIER") of 1.05 and a debt service coverage ("DSC") ratio of
21 1.0. Staff's analysis was based on a long-term loan of \$30,000,000 at 5.69 percent, and results in a
22 pro-forma TIER of 1.51 and a pro-forma DSC of 1.13. Staff recommends an 8 percent interest rate
23 cap to insure that debt issuance remains consistent with sound financial principles.

24 10. Accordingly, based upon its analysis and identified concerns, Staff recommends that
25 the interim financing be approved in the amount of \$23,700,000², and that the replacement permanent
26

27 ¹ AEPCO recently spun-off its transmission and one other entity, with cash being distributed amongst the three
28 entities in proportion to their respective assets. Therefore, according to Staff, financial statements for AEPCO as a stand-
alone generation-only entity are not yet available

² \$30,000,000 less the \$6,291,052 already paid.

1 financing be approved for the entire \$30,000,000.

2 CONCLUSIONS OF LAW

3 1. AEPCO is a public service corporation within the meaning of Article XV of the
4 Arizona Constitution and A.R.S. §§ 40-301 and 40-302.

5 2. The Commission has jurisdiction over AEPCO and the subject matter of the
6 application.

7 3. Notice of the requested financing was given to AEPCO's members.

8 4. Staff's recommendations set forth in Findings of Fact No. 8, 9 and 10 are reasonable
9 and should be adopted.

10 5. The financing approved herein is for lawful purposes within AEPCO's corporate
11 powers; is compatible with the public interest, with sound financial practices, and with the proper
12 performance by AEPCO of service as a public service corporation, and will not impair AEPCO's
13 ability to perform that service.

14 6. The financing approved herein is for the purposes stated in the application and is
15 reasonably necessary for those purposes, and such purposes are not, wholly or in part, reasonably
16 chargeable to operating expenses or to income.

17 ORDER

18 IT IS THEREFORE ORDERED that Arizona Electric Cooperative, Inc. is authorized to
19 borrow up to \$23,700,000, on an interim basis, from either the National Rural Utilities Cooperative
20 Finance Corporation and/or the Rural Utilities Service.

21 IT IS FURTHER ORDERED that Arizona Electric Cooperative, Inc. is authorized to replace
22 the interim financing with permanent financing from the Rural Utilities Service and the Federal
23 Financing Bank, in an amount no greater than \$30,000,000.

24 IT IS FURTHER ORDERED that the terms of all financings authorized herein shall include a
25 cap on the interest rate at 8 percent.

26 IT IS FURTHER ORDERED that Arizona Electric Cooperative, Inc. is hereby authorized to
27 engage in any transactions and to execute any documents necessary to effectuate the authorization
28 granted herein.

1 IT IS FURTHER ORDERED that Arizona Electric Cooperative, Inc. is hereby authorized to
2 issue such liens or other security in relation to its property as may be required to secure the
3 borrowings.

4 IT IS FURTHER ORDERED that such authority is expressly contingent upon Arizona
5 Electric Cooperative, Inc.'s use of the proceeds for the purposes set forth in its application.

6 IT IS FURTHER ORDERED that approval of the financing set forth herein does not
7 constitute or imply approval or disapproval by the Commission of any particular expenditure of the
8 proceeds derived thereby for purposes of establishing just and reasonable rates.

9 IT IS FURTHER ORDERED that Arizona Electric Cooperative, Inc. shall file with the
10 Commission copies of all executed financing documents setting forth the terms of the financing,
11 within 30 days of obtaining such financing.

12 IT IS FURTHER ORDERED that Arizona Electric Cooperative, Inc. shall file with the
13 Commission a capital plan as discussed herein, no later than December 31, 2002.

14 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

15 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

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18 CHAIRMAN

COMMISSIONER

COMMISSIONER

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21 IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive
22 Secretary of the Arizona Corporation Commission, have
23 hereunto set my hand and caused the official seal of the
24 Commission to be affixed at the Capitol, in the City of Phoenix,
25 this 29th day of November, 2001.

26
27 BRIAN C. McNEIL
28 EXECUTIVE SECRETARY

DISSENT _____
LAF:dap

1 SERVICE LIST FOR:

ARIZONA ELECTRIC COOPERATIVE, INC.

2 DOCKET NO.

E-01773A-01-0701

3

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9 Christopher Kempley, Chief Counsel
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12 1200 West Washington Street
13 Phoenix, Arizona 85007

14 Ernest G. Johnson, Director
15 Utilities Division
16 ARIZONA CORPORATION COMMISSION
17 1200 West Washington Street
18 Phoenix, Arizona 85007

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FOR FFB USE ONLY:

Note Identifier: _____

Purchase Date: _____

FOR RUS USE ONLY:RUS
Note
Number: _____Last Day
for an
Advance (¶3)March 31, 2006Maximum
Principal
Amount (¶4)\$6,315,000Final
Maturity
Date (¶5)December 31, 2020First Principal
Payment
Date (¶8)March 31, 2004Security
Instrument
(¶24)Consolidated Mortgage
and Security Agreement,
dated as of June 14,
1989, made by and among
Arizona Electric Power
Cooperative, Inc.,
United States of
America and National
Rural Utilities
Cooperative Finance
Corporation
(ARIZONA 28-L8 APACHE)Note
Date March 1, 2002Place
of
Issue Benson,
Arizona**FUTURE ADVANCE PROMISSORY NOTE****1. Promise to Pay.****FOR VALUE RECEIVED,****ARIZONA ELECTRIC POWER COOPERATIVE, INC.**

(the "Borrower," which term includes any successors or assigns) promises to pay the **FEDERAL FINANCING BANK** ("FFB," which term includes any successors or assigns) at the times, in the manner, and with interest at the rates to be established as hereinafter

provided, such amounts as may be advanced from time to time by FFB to the Borrower under this Note (each such amount being an "Advance", and more than one such amount being "Advances").

2. Reference to Note Purchase Commitment and Servicing Agreement; RUS as Successor to REA.

This Note is entitled to the benefits of, and is subject to the requirements of, the Note Purchase Commitment and Servicing Agreement dated as of January 1, 1992, between FFB and the Administrator of the Rural Electrification Administration ("REA"), as amended (such agreement, as it has heretofore been, and as it may hereafter be, amended, supplemented, or restated from time to time in accordance with its terms, being the "Agreement"). The Administrator of the Rural Utilities Service ("RUS") is the successor to the Administrator of REA pursuant to Public Law No. 103-354, 108 Stat. 3209 (1994), and Secretary of Agriculture Memorandum 1010-1 dated October 20, 1994.

3. Advances; Advance Requests; RUS Approval Requirement; Last Day for an Advance.

(a) FFB shall make Advances to the Borrower from time to time under this Note, in each case upon the written request by the Borrower for an Advance under this Note, in the form of request attached to this Note as Annex A (each such request being an "Advance Request"), making reference to the particular "Note Identifier" (as that term is defined in the Agreement) that FFB assigns to this Note (as provided in the Agreement) and specifying:

(1) the particular amount of funds that the Borrower requests to be advanced (such amount being the "Requested Advance Amount" for the respective Advance);

(2) the particular calendar date that the Borrower requests to be the date on which the respective Advance is to be made (such date being the "Requested Advance Date" for such Advance), which date must be a Business Day;

(3) the particular bank account to which the Borrower requests that the respective Advance be made;

(4) the particular calendar date that the Borrower selects to be the date on which the respective Advance is to mature (such date being the "Maturity Date" for such Advance), which date must meet the criteria for Maturity Dates prescribed in paragraph 5 of this Note;

(5) with respect to each Advance for which the Borrower selects a Maturity Date that will occur on or after the particular date specified on page 1 of this Note as being the "First Principal Payment Date," the particular method for the repayment of principal that the Borrower selects for the respective Advance from among the options described in subparagraph (b) of paragraph 8 of this Note; and

(6) with respect to each Advance for which the Borrower selects a Maturity Date that will occur on or after the fifth anniversary of the Requested Advance Date specified in the respective Advance Request, the particular prepayment/refinancing privilege that the Borrower elects for such Advance from between the options described in subparagraphs (b) and (c) of paragraph 16 of this Note.

(b) To be effective, an Advance Request must first be delivered to RUS for approval and be approved by RUS in writing, and such Advance Request, together with written notification of RUS's approval thereof, must be received by FFB on or before the third Business Day before the Requested Advance Date specified in such Advance Request.

(c) FFB shall make each requested Advance on the Requested Advance Date specified in the respective Advance Request, subject to the provisions of the Agreement describing certain circumstances under which a requested Advance shall be made on a later date; provided, however, that no Advance shall be made under this Note after the particular date specified on page 1 of this Note as being the "Last Day for an Advance."

(d) FFB shall make each requested Advance by electronic funds transfer to the particular bank account specified in the respective Advance Request.

(e) The Borrower hereby agrees that each Advance made by FFB in accordance with an RUS-approved Advance Request delivered to FFB shall reduce, by the amount of the respective Advance made, FFB's remaining commitment to make Advances under this Note.

4. Principal Amount of Advances; Maximum Principal Amount.

The principal amount of each Advance shall be the Requested Advance Amount specified in the respective Advance Request; provided, however, that the aggregate principal amount of all Advances made under this Note shall not exceed the particular amount specified on page 1 of this Note as being the "Maximum Principal Amount."

5. Maturity Dates for Advances.

Each Advance shall mature on the Maturity Date specified in the respective Advance Request, provided that such Maturity Date meets the following criteria:

(a) the Maturity Date for the respective Advance must be a "Payment Date" (as that term is defined in paragraph 7 of this Note);

(b) the Maturity Date for the respective Advance may not be a date that will occur after the particular date specified on page 1 of this Note as being the "Final Maturity Date" (such date being the "Final Maturity Date"); and

(c) the period of time between the Requested Advance Date for the respective Advance and the Maturity Date for such Advance may not be less than one complete calendar quarter.

6. Computation of Interest on Advances.

(a) Subject to paragraphs 11 and 17 of this Note, interest on the outstanding principal of each Advance shall accrue from the date on which the respective Advance is made to the date on which such principal is due.

(b) Interest on each Advance shall be computed on the basis of (1) actual days elapsed from (but not including) the date on which the respective Advance is made (for the first payment of interest due under this Note for such Advance) or the date on which the payment of interest was last due (for all other payments of interest due under this Note for such Advance), to (and including) the date on which the payment of interest is next due; and (2) a year of 365 days (except in calendar years including February 29, when the basis shall be a 366-day year).

(c) The basic interest rate for each Advance shall be established by FFB, as of the date on which the respective Advance is made, on the basis of the determination made by the Secretary of the Treasury pursuant to section 6(b) of the Federal Financing Bank Act of 1973, as amended (codified at 12 U.S.C. § 2281 et seq.) (the "FFB Act"); provided, however, that the shortest maturity used as the basis for any rate determination shall be the remaining maturity of the most recently auctioned United States Treasury bills having the shortest maturity of all United States Treasury bills then being regularly auctioned.

(d) In the event that (1) the Borrower has selected for any Advance a Maturity Date that will occur on or after the fifth anniversary of the Requested Advance Date for such Advance, and (2) the Borrower has elected for such Advance a prepayment/refinancing privilege described in subparagraph (c) of paragraph 16 of this Note, then the interest rate for such Advance shall also include a price (expressed in terms of a basis point increment to the applicable basic interest rate) for the particular prepayment/refinancing privilege that the Borrower selected, which price shall be established by FFB on the basis of a determination made by FFB as to the difference between (A) the estimated market yield of a notional obligation if such obligation were to (i) be issued by the Secretary of the Treasury, (ii) have a maturity comparable to the maturity of such Advance, and (iii) include prepayment and refinancing privileges identical to the particular prepayment/refinancing privilege that the Borrower elected for such Advance, and (B) the estimated market yield of a notional obligation if such obligation were to (i) be issued by the Secretary of the Treasury, (ii) have a maturity comparable to the maturity of such Advance, but (iii) not include such prepayment and refinancing privileges.

7. Payment of Interest; Payment Dates.

Interest accrued on the outstanding principal amount of each Advance shall be due and payable quarterly on the last day of each calendar quarter (each such day being a "Payment Date"), beginning (except as provided below) on the first Payment Date to occur after the date on which the respective Advance is made, up through and including the Maturity Date of such Advance; provided, however, that with respect to each Advance that is made in the last month of any calendar quarter, payments of accrued interest on the outstanding principal amount of the respective Advance shall be due beginning on the second Payment Date to occur after the date on which such Advance is made.

8. Repayment of Principal; Principal Repayment Options.

(a) The principal amount of each Advance shall be payable in quarterly installments, which installments shall be due beginning on the particular date specified on page 1 of this Note as being the "First Principal Payment Date" (such date being the "First Principal Payment Date"), and shall be due on each Payment Date to occur thereafter until the principal amount of the respective Advance is repaid in full on or before the Final Maturity Date; provided, however, that with respect to each Advance that is made after the First Principal Payment Date, principal installments shall be due beginning on the second Payment Date to occur after

the date on which the respective Advance is made; and provided, further, however, that for so long as the Borrower has not selected a method for the repayment of principal for any of the Advances made under this Note from among the options described in subparagraph (b) of this paragraph 8, the First Principal Payment Date of this Note may be deferred by the mutual agreement of the Borrower, RUS, and FFB, provided that a written amendment to this Note reciting the new and later First Principal Payment Date shall have been executed by the Borrower, approved by RUS, and received by FFB on or before the third Business Day before the First Principal Payment Date that is in effect immediately before such deferral.

(b) At the time that the Borrower first selects for any Advance a Maturity Date that will occur on or after the First Principal Payment Date, the Borrower must also select, subject to RUS approval, a method for the repayment of principal of such Advance (each such Advance being an "Amortizing Advance") from among the following options:

(1) "equal principal installments" -- the amount of each quarterly principal installment shall be substantially equal to the amount of every other quarterly principal installment and shall be sufficient, when added to all other such quarterly installments of equal principal, to repay the principal amount of such Amortizing Advance in full on the Final Maturity Date (notwithstanding the fact that the Borrower may have selected a Maturity Date for such Amortizing Advance that will occur before the Final Maturity Date);

(2) "graduated principal installments" -- the amount of each of the first one-third (or nearest number of payments that rounds to one-third) of the total number of quarterly principal installments shall be substantially equal to one-half of the amount of each of the remaining quarterly principal installments, and shall be sufficient, when added to all other such quarterly installments of graduated principal, to repay the principal amount of such Amortizing Advance in full on the Final Maturity Date (notwithstanding the fact that the Borrower may have selected a Maturity Date for such Amortizing Advance that will occur before the Final Maturity Date); or

(3) "level debt service" -- the amount of each quarterly payment consisting of a principal installment and accrued interest shall be substantially equal to the amount of every other quarterly payment consisting of a principal

installment and accrued interest, and shall be sufficient, when added to all other such level quarterly payments consisting of a principal installment and accrued interest, to repay the principal amount of such Amortizing Advance in full on the Final Maturity Date (notwithstanding the fact that the Borrower may have selected a Maturity Date for such Amortizing Advance that will occur before the Final Maturity Date).

(c) For each Amortizing Advance, the amount of principal that shall be due and payable on each of the dates specified in subparagraph (a) of this paragraph 8 shall be the amount of the principal installment due under a principal repayment schedule for the respective Amortizing Advance that is computed in accordance with the principles of the particular method for the repayment of principal that is selected by the Borrower for such Amortizing Advance from among the options described in subparagraph (b) of this paragraph 8. Except at the times described in the immediately following sentence, the method for the repayment of principal that is selected by the Borrower for any Amortizing Advance, and the resulting principal repayment schedule that is so computed for such Amortizing Advance, may not be changed. Notwithstanding the foregoing, with respect to each Amortizing Advance for which the Borrower has selected a Maturity Date that will occur before the Final Maturity Date, the Borrower may change the particular method for the repayment of principal that was selected by the Borrower for the respective Amortizing Advance from either the "equal principal installments" method or the "graduated principal installments" method to the "level debt service" method at the time (if ever) that the Borrower elects to extend the maturity of such Amortizing Advance (as provided in paragraph 15 of this Note), effective as of the effective date of such maturity extension, or at the time (if ever) that the Borrower elects to refinance the outstanding principal amount of such Amortizing Advance (as provided in paragraph 18 of this Note), effective as of the effective date of such refinancing, and the principal repayment schedule for such Amortizing Advance shall thereupon be newly computed in accordance with the "level debt service" method for the repayment of principal. After the Borrower has selected the Final Maturity Date as the Maturity Date for any Amortizing Advance, the Borrower may so change the particular method for the repayment of principal of any Amortizing Advance, and the principal repayment schedule for such Amortizing Advance shall be so newly computed, only at the time (if ever) that the Borrower elects to refinance the outstanding principal amount of such Amortizing Advance (as provided in paragraph 18 of this Note), effective as of the effective date of such refinancing.

(d) With respect to each Advance that has a Maturity Date that will occur before the Final Maturity Date, the entire unpaid principal amount of the respective Advance shall be payable on such Maturity Date, subject to extensions of the maturity of such Advance (as provided in paragraph 15 of this Note).

(e) Notwithstanding which of the methods for the repayment of principal described in subparagraph (b) of this paragraph 8 is selected by the Borrower for any Amortizing Advance, the aggregate of all quarterly payments of principal and interest on such Amortizing Advance shall be such as will repay the entire principal amount of such Amortizing Advance, and pay all interest accrued thereon, on or before the Final Maturity Date.

9. Fee.

A fee to cover expenses and contingencies, assessed by FFB pursuant to section 6(c) of the FFB Act, shall accrue on the outstanding principal amount of each Advance from the date on which the respective Advance is made to the date on which the principal amount of such Advance is due. The fee on each Advance shall be equal to one-eighth of one percent (0.125%) per annum of the unpaid principal balance of such Advance. The fee on each Advance shall be computed in the same manner as accrued interest is computed under paragraph 6(b) of this Note, and shall be due and payable at the same times as accrued interest is due and payable under paragraph 7 of this Note (adjusted as provided in paragraph 10 of this Note if a Payment Date is not a Business Day). The fee on each Advance shall be credited to RUS as required by section 505(c) of the Federal Credit Reform Act of 1990, as amended (codified at 2 U.S.C. § 661d(c)).

10. Business Days.

(a) Whenever any Payment Date, the Maturity Date for any Advance, or the Final Maturity Date shall fall on a day on which either FFB or the Federal Reserve Bank of New York is not open for business, the payment that would otherwise be due on such Payment Date, Maturity Date, or Final Payment Date, as the case may be, shall be due on the first day thereafter on which FFB and the Federal Reserve Bank of New York are both open for business (any such day being a "Business Day").

(b) In the event that any Payment Date falls on a day other than a Business Day, then the extension of time for making the payment that would otherwise be due on such Payment Date shall be (1) taken into account in establishing the interest rate for the respective Advance, (2) included in computing interest due in

connection with such payment, and (3) excluded in computing interest due in connection with the next payment.

(c) In the event that the Maturity Date for any Advance or the Final Maturity Date falls on a day other than a Business Day, then the extension of time for making the payment that would otherwise be due on such Maturity Date or the Final Maturity, as the case may be, shall be (1) taken into account in establishing the interest rate for such Advance, and (2) included in computing interest due in connection with such payment.

11. Late Payments.

(a) In the event that any payment of any amount owing under this Note is not made when and as due (any such amount being then an "Overdue Amount"), then the amount payable shall be such Overdue Amount plus interest thereon (such interest being the "Late Charge") computed in accordance with this subparagraph (a).

(1) The Late Charge shall accrue from the scheduled date of payment for the Overdue Amount (taking into account paragraph 10 of this Note) to the date on which payment is made.

(2) The Late Charge shall be computed on the basis of (A) actual days elapsed from (but not including) the scheduled date of payment for such Overdue Amount (taking into account paragraph 10 of this Note) to (and including) the date on which payment is made, and (B) a year of 365 days (except in calendar years including February 29, when the basis shall be a 366-day year).

(3) The Late Charge shall accrue at a rate (the "Late Charge Rate") equal to one and one-half times the rate to be determined by the Secretary of the Treasury taking into consideration the prevailing market yield on the remaining maturity of the most recently auctioned 13-week United States Treasury bills.

(4) The initial Late Charge Rate shall be in effect until the earlier to occur of either (A) the date on which payment of the Overdue Amount and the amount of the accrued Late Charge is made, or (B) the first Payment Date to occur after the scheduled date of payment for such Overdue Amount. In the event that the Overdue Amount and the amount of the accrued Late Charge are not paid on or before the such Payment Date, then the amount payable shall be the sum of the Overdue Amount and the amount of the accrued Late

Charge, plus a Late Charge on such sum accruing at a new Late Charge Rate to be then determined in accordance with the principles of clause (3) of this subparagraph (a). For so long as any Overdue Amount remains unpaid, the Late Charge Rate shall be redetermined in accordance with the principles of clause (3) of this subparagraph (a) on each Payment Date to occur thereafter, and shall be applied to the Overdue Amount and all amounts of the accrued Late Charge to the date on which payment of the Overdue Amount and all amounts of the accrued Late Charge is made.

(b) Nothing in subparagraph (a) of this paragraph 11 shall be construed as permitting or implying that the Borrower may, without the written consent of FFB, modify, extend, alter or affect in any manner whatsoever (except as explicitly provided herein) the right of FFB to receive any and all payments on account of this Note on the dates specified in this Note.

12. Final Due Date.

Notwithstanding anything in this Note to the contrary, all amounts outstanding under this Note remaining unpaid as of the Final Maturity Date shall be due and payable on the Final Maturity Date.

13. Manner of Making Payments.

(a) For so long as FFB is the holder of this Note and RUS is the loan servicing agent for FFB (as provided in the Agreement), each payment under this Note shall be made in immediately available funds by electronic funds transfer to the account specified from time to time by RUS, as loan servicing agent for FFB, in a written notice delivered by RUS to the Borrower.

(b) In the event that FFB is the holder of this Note but RUS is not the loan servicing agent for FFB, then each payment under this Note shall be made in immediately available funds by electronic funds transfer to the account specified from time to time by FFB in a written notice delivered by FFB to the Borrower.

(c) In the event that FFB is not the holder of this Note, then each payment under this Note shall be made in the manner and to the account specified from time to time by the holder in a written notice delivered by the holder to the Borrower.

14. Application of Payments.

Each payment made on this Note shall be applied, first, to the payment of Late Charges (if any) payable under paragraphs 11 and 19 of this Note, then to the payment of premiums (if any) payable under paragraphs 17 and 18 of this Note, then to the payment of unpaid accrued interest, then on account of outstanding principal, and then to the payment of the fee payable under paragraph 9 of this Note.

15. Maturity Extensions.

(a) With respect to each Advance for which the Borrower has selected a Maturity Date that will occur before the Final Maturity Date (each such Maturity Date being an "Interim Maturity Date"), the Borrower may, effective as of such Interim Maturity Date, elect to extend the maturity of all or any portion of the outstanding principal amount of the respective Advance (subject to subparagraph (c) of this paragraph 15) to a new Maturity Date to be selected by the Borrower in the manner and subject to the limitations specified in this subparagraph (a) (each such election being a "Maturity Extension Election"; each such elective extension of the maturity of any Advance that has an Interim Maturity Date being a "Maturity Extension"; and the Interim Maturity Date that is in effect for an Advance immediately before any such elective Maturity Extension being, from and after such Maturity Extension, the "Maturity Extension Effective Date").

(1) Except under the circumstances described in clause (3) of this subparagraph (a), the Borrower shall deliver to FFB (with a copy to RUS) written notification of each Maturity Extension Election, in the form of notification attached to this Note as Annex B-1 (each such notification being a "Maturity Extension Election Notice"), making reference to the "Advance Identifier" (as that term is defined in the Agreement) that FFB assigned to such Advance (as provided in the Agreement) and specifying, among other things, the following:

(A) the amount of the outstanding principal of the such Advance with respect to which the Borrower elects to extend the maturity (subject to subparagraph (c) of this paragraph 15); and

(B) the new Maturity Date that the Borrower selects to be in effect for such principal amount after the respective Maturity Extension Effective Date, which date:

(i) may be either a new Interim Maturity Date or the Final Maturity Date; and

(ii) in the event that the Borrower selects a new Interim Maturity Date as the new Maturity Date for any Advance, must meet the criteria for Maturity Dates prescribed in paragraph 5 of this Note (provided, however, that, for purposes of selecting a new Maturity Date in connection with a Maturity Extension Election, the reference to "the Requested Advance Date for the respective Advance" in subparagraph (c) of paragraph 5 of this Note shall be deemed to be a reference to "the respective Maturity Extension Effective Date").

(2) To be effective, a Maturity Extension Election Notice must be received by FFB on or before the third Business Day before the Interim Maturity Date in effect for the respective Advance immediately before such Maturity Extension.

(3) In the event that either of the circumstances described in subclause (A) or (B) of the next sentence occurs, then a Maturity Extension Election Notice (in the form of notice attached to this Note as Annex B-2), to be effective, must first be delivered to RUS for approval and be approved by RUS in writing, and such Maturity Extension Election Notice, together with written notification of RUS's approval thereof, must be received by FFB on or before the third Business Day before the Interim Maturity Date in effect for the respective Advance immediately before such Maturity Extension. RUS approval of a Maturity Extension Election Notice will be required under either of the following circumstances:

(A) (i) any payment of any amount owing under this Note is not made by the Borrower when and as due, (ii) payment is made by RUS in accordance with the guarantee set forth at the end of this Note, and (iii) RUS delivers notice to both the Borrower and FFB advising each of them that each Maturity Extension Election Notice delivered by the Borrower after the date of such notice shall require the approval of RUS; or

(B) FFB at any time delivers notice to both the Borrower and RUS advising each of them that each Maturity Extension Election Notice delivered by the

Borrower after the date of such notice shall require the approval of RUS.

(b) With respect to any Advance that has an Interim Maturity Date, in the event that FFB does not receive a Maturity Extension Election Notice (and, if required under clause (3) of subparagraph (a) of this paragraph 15, written notification of RUS's approval thereof) on or before the third Business Day before such Interim Maturity Date, then the maturity of such Advance shall be extended automatically in the manner and subject to the limitations specified in this subparagraph (b) (each such automatic extension of the maturity of any Advance that has an Interim Maturity Date also being a "Maturity Extension"; and the Interim Maturity Date that is in effect for an Advance immediately before any such automatic Maturity Extension also being, from and after such Maturity Extension, the "Maturity Extension Effective Date").

(1) The new Maturity Date for such Advance shall be the immediately following quarterly Payment Date.

(2) If the Interim Maturity Date that is in effect for such Advance immediately before such automatic Maturity Extension is:

(A) a Payment Date that occurs before the First Principal Payment Date (i.e., such Advance is not an Amortizing Advance), then the amount of principal that will have its maturity extended automatically shall be the entire outstanding principal amount of such Advance;

(B) the Payment Date that immediately precedes the First Principal Payment Date, then the method for the repayment of principal that shall apply to such Advance from and after the respective Maturity Extension Effective Date shall be the "level debt service" method; and

(C) either the First Principal Payment Date or a Payment Date that occurs after the First Principal Payment Date (i.e., such Advance is an Amortizing Advance), then:

(i) the amount of principal that will have its maturity extended automatically shall be the outstanding principal amount of such Advance less the principal installment that is due on the

respective Maturity Extension Effective Date (as provided in subparagraph (c) of this paragraph 15; and

(ii) the method for the repayment of principal that shall apply to such Advance from and after the respective Maturity Extension Effective Date shall be the same method that applied to such Advance immediately before such Maturity Extension Effective Date.

(c) In the event that the maturity of any Amortizing Advance that has an Interim Maturity Date is extended under either subparagraph (a) or (b) of this paragraph 15, then the principal installment that is due on the respective Maturity Extension Effective Date, in accordance with the principal repayment schedule that applied to such Amortizing Advance immediately before such Maturity Extension Effective Date, shall nevertheless be due and payable on such Maturity Extension Effective Date notwithstanding such Maturity Extension.

(d) In the event that the maturity of any Advance that has an Interim Maturity Date is extended under either subparagraph (a) or (b) of this paragraph 15, then the basic interest rate for such Advance, from and after the respective Maturity Extension Effective Date, shall be the particular rate that is established by FFB, as of such Maturity Extension Effective Date, in accordance with the principles of subparagraph (c) of paragraph 6 of this Note.

(e) In the event that (1) the maturity of any Advance that has an Interim Maturity Date is extended under either subparagraph (a) or (b) of this paragraph 15, and (2) the Maturity Date for such extended Advance is a date that will occur before the fifth anniversary of the respective Maturity Extension Effective Date, then the prepayment/refinancing privilege described in subparagraph (b) of paragraph 16 of this Note shall apply automatically to such Advance.

(f) In the event that (1) the Borrower makes a Maturity Extension Election with respect to any Advance that has an Interim Maturity Date, and (2) the Borrower selects as the Maturity Date for such extended Advance a new Maturity Date that will occur on or after the fifth anniversary of the respective Maturity Extension Effective Date, then the Borrower must elect a prepayment/refinancing privilege for such extended Advance from between the options described in subparagraphs (b) and (c) of paragraph 16 of this Note (provided, however, that each of the

references to "the Requested Advance Date for such Advance" in subparagraph (c) of paragraph 16 of this Note shall be deemed to be a reference to "the respective Maturity Extension Effective Date". The Maturity Extension Election Notice delivered by the Borrower in connection with each such Maturity Extension Election must also specify the particular prepayment/refinancing privilege that the Borrower elects for the respective extended Advance. In the event that the Borrower elects for any such extended Advance a prepayment/refinancing privilege described in subparagraph (c) of paragraph 16 of this Note, then the interest rate for such extended Advance, from and after the respective Maturity Extension Effective Date, shall include a price (expressed in terms of a basis point increment to the applicable basic interest rate) for the particular prepayment/refinancing privilege that the Borrower elects, which price shall be established by FFB, as of such Maturity Extension Effective Date, in accordance with the principles of subparagraph (d) of paragraph 6 of this Note.

(g) In the event that the maturity of any Amortizing Advance that has an Interim Maturity Date is extended under either subparagraph (a) or (b) of this paragraph 15, then the outstanding principal amount of such Amortizing Advance, after the respective Maturity Extension Effective Date, shall be due and payable in accordance with this subparagraph (g).

(1) With respect to each Amortizing Advance to which either the "equal principal installments" method or the "graduated principal installments" method for the repayment of principal applies, the amount of the quarterly principal installments that will be due after the respective Maturity Extension Effective Date shall be equal to the amount of the quarterly installments of equal principal or graduated principal, as the case may be, that were due in accordance with the principal repayment schedule that applied to such Amortizing Advance immediately before such Maturity Extension Effective Date.

(2) With respect to each Amortizing Advance to which the "level debt service" method for the repayment of principal applies, the amount of the level quarterly payments consisting of a principal installment and accrued interest that will be due after the respective Maturity Extension Effective Date shall be newly computed so that the amount of each such quarterly payment consisting of a principal installment and accrued interest (taking into account the new interest rate that is in effect for such Amortizing Advance from and after such Maturity Extension Effective Date) shall be substantially equal to the amount

of every other quarterly payment consisting of a principal installment and accrued interest, and shall be sufficient, when added to all other such newly-computed level quarterly payments consisting of a principal installment and accrued interest, to repay the outstanding principal amount of such Amortizing Advance in full on the Final Maturity Date (notwithstanding the fact that the Borrower may have selected an Interim Maturity Date for such Amortizing Advance).

(3) For each such Amortizing Advance, the quarterly installments of equal principal or graduated principal, or the newly-computed level quarterly payments consisting of a principal installment and accrued interest, as the case may be, shall be due beginning on the first Payment Date to occur after the respective Maturity Extension Effective Date, and shall be due on each Payment Date to occur thereafter up through and including the earlier to occur of either (A) the new Maturity Date for such extended Amortizing Advance, on which date the entire unpaid principal amount of such extended Amortizing Advance shall also be payable, subject to further Maturity Extensions if the new Maturity Date is an Interim Maturity Date, or (B) the date on which the entire principal amount of such extended Amortizing Advance, and all unpaid interest (and Late Charges, if any) accrued thereon, are paid.

(h) The maturity of each Advance may be extended more than once as provided in this paragraph 15, but upon the occurrence of the Final Maturity Date, no further Maturity Extensions may occur.

16. Prepayment/Refinancing Privileges.

(a) The prepayment/refinancing privilege described in subparagraph (b) of this paragraph 16 shall apply automatically to each Advance that has a Maturity Date that will occur before the fifth anniversary of the Requested Advance Date specified in the respective Advance Request. With respect to each Advance for which the Borrower has selected a Maturity Date that will occur on or after the fifth anniversary of the Requested Advance Date specified in the respective Advance Request, the Borrower must elect, at the time of requesting the respective Advance, the particular prepayment/refinancing privilege that is to apply to such Advance from between the options described in subparagraphs (b) and (c) of this paragraph 16.

(b) "Market Value Premium (or Discount)" -- The Borrower shall have the privilege to prepay the respective Advance (as provided in paragraph 17 of this Note) or to refinance such Advance (as provided in paragraph 18 of this Note) at a prepayment or refinancing price that will include, in either case, a premium (or discount credit) equal to the difference between:

(1) the price for such Advance that would, if such Advance (including all unpaid interest accrued thereon through the date of prepayment or refinancing, as the case may be) were purchased by a third party and held to the Maturity Date of such Advance, produce a yield to the third-party purchaser for the period from the date of purchase to the Maturity Date of such Advance substantially equal to the interest rate that would be set on a loan from the Secretary of the Treasury to FFB to purchase an obligation having a payment schedule identical to the payment schedule of such Advance for the period from the date of prepayment or refinancing, as the case may be, to the Maturity Date of such Advance; and

(2) the sum of:

(A) the outstanding principal amount of such Advance on the date of prepayment or refinancing, as the case may be (after taking into account the payment of the principal installment (if any) that is due on date of prepayment or refinancing, as the case may be, in accordance with the principal repayment schedule that applied to such Advance immediately before such prepayment or refinancing); and

(B) all unpaid interest accrued on such Advance through the date of prepayment or refinancing, as the case may be,

(the difference between the price described in clause (1) of this subparagraph (b) and the sum of the amounts described in clause (2) of this subparagraph (b) being the "Market Value Premium (or Discount)"). The price described in clause (1) of this subparagraph (b) shall be calculated by the Secretary of the Treasury as of the close of business on the second Business Day before the date of prepayment or refinancing, as the case may be, using standard calculation methods of the United States Department of the Treasury.

(c) "Fixed Premium" -- The Borrower shall have the privilege to prepay the respective Advance (as provided in paragraph 17 of this Note) or to refinance such Advance (as provided in paragraph 18 of this Note) at a prepayment or refinancing price that will include, in either case, a fixed premium determined by the Borrower having made, at the time of requesting such Advance, both the election and selection described in this subparagraph (c).

(1) "No-Call Period Option Election" -- First, the Borrower must elect whether or not the fixed premium prepayment/refinancing privilege that is to apply to the respective Advance shall include a 5-year period during which such Advance shall not be eligible for any prepayment or refinancing (such time period being a "No-Call Period"). The options are:

(A) "yes" -- the Borrower elects to have the fixed premium prepayment/refinancing privilege include a 5-year No-Call Period, i.e., the Borrower shall have the privilege to prepay the respective Advance (as provided in paragraph 17 of this Note) or to refinance such Advance (as provided in paragraph 18 of this Note) on or after (but not before):

(i) the fifth anniversary of the Requested Advance Date for such Advance (if such fifth anniversary date is a Payment Date); or

(ii) the first Payment Date to occur after the fifth anniversary of the Requested Advance Date for such Advance (if such fifth anniversary date is not a Payment Date),

(in either case, such date being the "First Call Date" for such Advance); or

(B) "no" -- the Borrower elects to have the fixed premium prepayment/refinancing privilege not include a 5-year No-Call Period, i.e., the Borrower shall have the privilege to prepay the respective Advance (as provided in paragraph 17 of this Note) or to refinance such Advance (as provided in paragraph 18 of this Note) without a 5-year period during which such Advance shall not be eligible for any prepayment or refinancing.

(2) "Premium Option Selection" -- Second the Borrower must select the particular fixed premium that will be

required in connection with any prepayment or refinancing of the respective Advance. The options are:

(A) "10 percent premium declining over 10 years"
-- the price for any prepayment or refinancing of the respective Advance shall include a premium equal to 10 percent of the amount of principal being prepaid or refinanced, as the case may be, multiplied by a fraction:

(i) the numerator of which is the number of Payment Dates that occur between:

(aa) in the case of a prepayment, the date of prepayment (if such date is a Payment Date) or the Payment Date immediately preceding the date of prepayment (if the date of prepayment is not a Payment Date), and, in the case of a refinancing, the date of refinancing, which date, in either case, shall be included in computing the number of Payment Dates; and

(bb) the earlier to occur of either:

(I) the Maturity Date that the Borrower selected for such Advance; or

(II) the tenth anniversary of the applicable First Call Date (if the Borrower elected to have the prepayment/refinancing privilege include a 5-year No-Call Period) or the tenth anniversary of the Requested Advance Date (if the Borrower elected to have the prepayment/refinancing privilege not include a 5-year No-Call Period),

which date, in either case, shall be excluded in computing the number of Payment Dates; and

(ii) the denominator of which is 40,

and no premium (x) on or after the tenth anniversary of the applicable First Call Date (if the Borrower elected to have the prepayment/refinancing privilege include a 5-year No-Call Period) or the tenth anniversary of the Requested Advance Date (if the Borrower elected to have

the prepayment/refinancing privilege not include a 5-year No-Call Period), or (y) on the Maturity Date (if the Borrower selected a Maturity Date that will occur before the tenth anniversary of the First Call Date or the tenth anniversary of the Requested Advance Date, as the case may be);

(B) "5 percent premium declining over 5 years" -- the price for any prepayment or refinancing of the respective Advance shall include a premium equal to 5 percent of the amount of principal being prepaid or refinanced, as the case may be, multiplied by a fraction:

(i) the numerator of which is the number of Payment Dates that occur between:

(aa) in the case of a prepayment, the date of prepayment (if such date is a Payment Date) or the Payment Date immediately preceding the date of prepayment (if the date of prepayment is not a Payment Date), and, in the case of a refinancing, the date of refinancing, which date, in either case, shall be included in computing the number of Payment Dates; and

(bb) the earlier to occur of either:

(I) the Maturity Date that the Borrower selected for such Advance; or

(II) the fifth anniversary of the applicable First Call Date (if the Borrower elected to have the prepayment/refinancing privilege include a 5-year No-Call Period) or the fifth anniversary of the Requested Advance Date (if the Borrower elected to have the prepayment/refinancing privilege not include a 5-year No-Call Period),

which date, in either case, shall be excluded in computing the number of Payment Dates; and

(ii) the denominator of which is 20,

and no premium on or after the fifth anniversary of the applicable First Call Date (if the Borrower elected to have the prepayment/refinancing privilege include a 5-year No-Call Period) or the fifth anniversary of the Requested Advance Date (if the Borrower elected to have the prepayment/refinancing privilege not include a 5-year No-Call Period); or

(C) "par" -- the price for any prepayment or refinancing of the respective Advance shall include no premium.

17. Prepayments.

(a) The Borrower may elect to prepay all or any portion of the outstanding principal amount of any Advance made under this Note, or to prepay this Note in its entirety, in the manner, at the price, and subject to the limitations specified in this paragraph 17 (each such election being a "Prepayment Election").

(b) For each Prepayment Election in which the Borrower elects to prepay a particular amount of the outstanding principal of an Advance, the Borrower shall deliver to RUS written notification of the respective Prepayment Election, in the form of notification attached to this Note as Annex C-1 (each such notification being a Prepayment Election Notice), making reference to the Advance Identifier that FFB assigned to the respective Advance (as provided in the Agreement) and specifying, among other things, the following:

(1) the particular date on which the Borrower intends to make the prepayment on such Advance (such date being the "Intended Prepayment Date" for such Advance), which date:

(A) must be a Business Day; and

(B) for any Advance for which the Borrower has selected a fixed premium prepayment/refinancing privilege that includes a 5-year No-Call Period, may not be a date that will occur before the applicable First Call Date; and

(2) the amount of principal of the respective Advance that the Borrower intends to prepay, which amount may be either:

(A) the total outstanding principal amount of such Advance; or

(B) an amount less than the total outstanding principal amount of such Advance (subject to subparagraph (g) of this paragraph 17) (any such amount being a "Portion").

(c) For each Prepayment Election in which the Borrower elects to have a particular amount of funds applied by FFB toward the prepayment of the outstanding principal of an Advance, the Borrower shall deliver to RUS written notification of the respective Prepayment Election, in the form of notification attached to this Note as Annex C-2 (each such notification also being a Prepayment Election Notice), making reference to the Advance Identifier that FFB assigned to the respective Advance (as provided in the Agreement) and specifying, among other things, the following:

(1) the particular date on which the Borrower intends to make the prepayment on such Advance (such date being the "Intended Prepayment Date" for such Advance), which date:

(A) must be a Business Day; and

(B) for any Advance for which the Borrower has selected a fixed premium prepayment/refinancing privilege that includes a 5-year No-Call Period, may not be a date that will occur before the applicable First Call Date; and

(2) the particular amount of funds that the Borrower elects to be applied by FFB toward a prepayment of the outstanding principal amount of such Advance.

(d) To be effective, a Prepayment Election Notice must be approved by RUS in writing, and such Prepayment Election Notice, together with written notification of RUS's approval thereof, must be received by FFB on or before the fifth Business Day before the date specified therein as the Intended Prepayment Date for the respective Advance or Portion.

(e) The Borrower shall pay to FFB a price for the prepayment of any Advance, any Portion of any Advance, or this Note in its entirety (such price being the "Prepayment Price" for such Advance or Portion or this Note, as the case may be) determined as follows:

(1) in the event that the Borrower elects to prepay the entire outstanding principal amount of any Advance, then the

Borrower shall pay to FFB a Prepayment Price for such Advance equal to the sum of:

(A) the entire outstanding principal amount of such Advance on the Intended Prepayment Date;

(B) all unpaid interest (and Late Charges, if any) accrued on such Advance through the Intended Prepayment Date; and

(C) the amount of the premium or discount credit (if any) that is required under the particular prepayment/refinancing privilege that applies to such Advance;

(2) in the event that the Borrower elects to prepay a Portion of any Advance, then the Borrower shall pay to FFB a Prepayment Price for such Portion that would equal such Portion's pro rata share of the Prepayment Price that would be required for a prepayment of the entire outstanding principal amount of such Advance (determined in accordance with the principles of clause (1) of this subparagraph (e)); and

(3) in the event that the Borrower elects to prepay this Note in its entirety, then the Borrower shall pay to FFB an amount equal to the sum of the Prepayment Prices for all outstanding Advances (determined in accordance with the principles of clause (1) of this subparagraph (e)).

(f) Payment of the Prepayment Price for any Advance, any Portion of any Advance, or this Note in its entirety shall be due to FFB before 3:00 p.m. (Washington, D.C., time) on the Intended Prepayment Date for such Advance or Portion or this Note, as the case may be.

(g) Each prepayment of a Portion shall, as to the principal amount of such Portion, be subject to a minimum amount equal to \$100,000.00 of principal.

(h) In the event that the Borrower makes a Prepayment Election with respect to any Portion of an Amortizing Advance, then the Prepayment Price paid for such Portion shall be applied as provided in paragraph 14 of this Note and, with respect to application to outstanding principal, such Prepayment Price shall be applied to principal installments in the inverse order of maturity.

(i) In the event that the Borrower makes a Prepayment Election with respect to any Portion of an Amortizing Advance, then the outstanding principal amount of such Amortizing Advance, after such partial prepayment, shall be due and payable in accordance with this subparagraph (i).

(1) With respect to each Amortizing Advance to which either the "equal principal installments" method or the "graduated principal installments" method for the repayment of principal applies, the amount of the quarterly principal installments that will be due after such partial prepayment shall be equal to the quarterly installments of equal principal or graduated principal, as the case may be, that were due in accordance with the principal repayment schedule that applied to such Amortizing Advance immediately before such partial prepayment.

(2) With respect to each Amortizing Advance to which the "level debt service" method for the repayment of principal applies, the amount of the quarterly payments consisting of a principal installment and accrued interest that will be due after such partial prepayment shall be equal to the amount of the level debt service payments that were due in accordance with the level debt service payment schedule that applied to such Amortizing Advance immediately before such partial prepayment, and such payments shall be allocated by FFB between principal and accrued interest, as appropriate.

(3) For each such Amortizing Advance, the quarterly installments of equal principal or graduated principal, or level quarterly payments consisting of a principal installment and accrued interest, as the case may be, shall be due beginning on the first Payment Date to occur after such partial prepayment, and shall be due on each Payment Date to occur thereafter up through and including the earlier to occur of either (A) the Maturity Date for such Amortizing Advance, on which date the entire unpaid principal amount of such Amortizing Advance shall also be payable, subject to Maturity Extensions (as provided in paragraph 15 of this Note) if the Maturity Date is an Interim Maturity Date, or (B) the date on which the entire principal amount of such Amortizing Advance, and all unpaid interest (and Late Charges, if any) accrued thereon, are paid.

(j) The Borrower may make more than one Prepayment Election with respect to an Advance, each such Prepayment Election being

made with respect to a different Portion of such Advance, until such time as the entire principal amount of such Advance is repaid in full.

18. Refinancings.

(a) The Borrower may elect to refinance the outstanding principal amount of any Advance (but not any Portion) in the manner, at the price, and subject to the limitations specified in this paragraph 18 (each such election being a "Refinancing Election").

(b) Except under the circumstances described in subparagraph (d) of this paragraph 18, the Borrower shall deliver to FFB (with a copy to RUS) written notification of each Refinancing Election, in the form of notification attached to this Note as Annex D-1 (each such notification being a "Refinancing Election Notice"), making reference to the Advance Identifier that FFB assigned to the respective Advance (as provided in the Agreement) and specifying, among other things, the following:

(1) the particular date on which the Borrower intends to refinance the respective Advance (such date being the "Intended Refinancing Date" for the respective Advance), which date:

(A) must be a Payment Date; and

(B) for any Advance for which the Borrower has selected a prepayment/refinancing privilege that includes a 5-year No-Call Period, may not be a date that will occur before the applicable First Call Date;

(2) the amount of the outstanding principal of the respective Advance that the Borrower elects to refinance (subject to the clause (1) of subparagraph (e) of this paragraph 18); and

(3) the Maturity Date that the Borrower selects to be in effect for such principal amount after such refinancing, which date may be:

(A) the Maturity Date that is in effect for such Advance immediately before such refinancing; or

(B) a new Maturity Date that the Borrower selects in connection with such Refinancing Election, provided

that such new Maturity Date meets the criteria for Maturity Dates prescribed in paragraph 5 of this Note (provided, however, that for purposes of selecting a new Maturity Date in connection with a Refinancing Election, the reference to "the Requested Advance Date for the respective Advance" in subparagraph (c) of paragraph 5 of this Note shall be deemed to be a reference to "the respective Refinancing Effective Date").

(c) To be effective, a Refinancing Election Notice must be received by FFB on or before the fifth Business Day before the date specified therein as the Intended Refinancing Date.

(d) In the event that either of the circumstances described in clause (1) or (2) of the next sentence shall have occurred, then a Refinancing Election Notice (in the form of notice attached to this Note as Annex D-2), to be effective, must first be delivered to RUS for approval and be approved by RUS in writing, and such Refinancing Election Notice, together with written notification of RUS's approval thereof, must be received by FFB on or before the fifth Business Day before the date specified therein to be the Intended Refinancing Date. RUS approval of a Refinancing Election Notice will be required under either of the following circumstances:

(1) (A) payment of any amount owing under this Note is not made by the Borrower when and as due, (B) payment is made by RUS in accordance with the guarantee set forth at the end of this Note, and (C) RUS delivers notice to both the Borrower and FFB advising each of them that each Refinancing Election Notice delivered by the Borrower after the date of such notice shall require the approval of RUS; or

(2) FFB at any time delivers notice to both the Borrower and RUS advising each of them that each Refinancing Election Notice delivered by the Borrower after the date of such notice shall require the approval of RUS.

(e) The Borrower shall pay to FFB a price for the refinancing of any Advance (such price being the "Refinancing Price" for such Advance) equal to the sum of:

(1) the principal installment (if any) that is due on the particular Payment Date that the Borrower specified to be the Intended Refinancing Date, in accordance with the

principal repayment schedule that applied to such Advance immediately before such refinancing;

(2) all unpaid interest (and Late Charges, if any) accrued on such Advance through the Intended Refinancing Date; and

(3) the amount of the premium (if any) that is required under the particular prepayment/refinancing privilege that applies to such Advance.

In the event that (A) the prepayment/refinancing privilege that applies to the particular Advance being refinanced is the privilege described in subparagraph (b) of paragraph 16 of this Note, and (B) the Market Value Premium (or Discount) that is to be included in the Refinancing Price for such Advance is a discount on such Advance, then such discount shall be applied by FFB in the manner requested by the Borrower in a written notice delivered by the Borrower to FFB and approved by RUS in writing.

(f) Payment of the Refinancing Price for any Advance shall be due to FFB before 3:00 p.m. (Washington, D.C., time) on the Intended Refinancing Date for such Advance.

(g) In the event that a Refinancing Election Notice (and, if required under subparagraph (d) of this paragraph 18, written notification of RUS's approval thereof) is received by FFB on or before the fifth Business Day before the Intended Refinancing Date specified therein, then the refinancing of the respective Advance shall become effective on such Intended Refinancing Date (in such event, the Intended Refinancing Date being the "Refinancing Effective Date"). In the event that a Refinancing Election Notice (and, if required under subparagraph (d) of this paragraph 18, written notification of RUS's approval thereof) is received by FFB after the fifth Business Day before the Intended Refinancing Date specified therein, then the refinancing of the respective Advance shall become effective on the fifth Business Day to occur after the day on which such Refinancing Election Notice (and, if required under subparagraph (d) of this paragraph 18, written notification of RUS's approval thereof) is received by FFB (in such event, the fifth Business Day to occur after the day on which such Refinancing Election Approval Notice (and, if required under subparagraph (d) of this paragraph 18, written notification of RUS's approval thereof) is received by FFB being the "Refinancing Effective Date"), provided that the Borrower shall have paid to FFB, in addition to the Refinancing Price required under subparagraph (e) of this paragraph 18, the

interest accrued from the Intended Refinancing Date through such Refinancing Effective Date.

(h) In the event that the Borrower makes a Refinancing Election with respect to any Advance, the basic interest rate for such Advance, from and after the respective Refinancing Effective Date, shall be the particular rate that is established by FFB, as of such Refinancing Effective Date, in accordance with the principles of subparagraph (c) of paragraph 6 of this Note.

(i) In the event that (1) the Borrower makes a Refinancing Election with respect to any Advance, and (2) the Borrower selects as the Maturity Date for such refinanced Advance either (A) the Maturity Date that is in effect for such Advance immediately before such refinancing, and such Maturity Date will occur before the fifth anniversary of the respective Refinancing Effective Date, or (B) a new Maturity Date that will occur before the fifth anniversary of the respective Refinancing Effective Date, then the prepayment/refinancing privilege described in subparagraph (b) of paragraph 16 of this Note shall apply automatically to such Advance.

(j) In the event that (1) the Borrower makes a Refinancing Election with respect to any Advance, and (2) the Borrower selects as the Maturity Date for such refinanced Advance either (A) the Maturity Date that is in effect for such Advance immediately before such refinancing, and such Maturity Date will occur on or after the fifth anniversary of the respective Refinancing Effective Date, or (B) a new Maturity Date that will occur on or after the fifth anniversary of the respective Refinancing Effective Date, then the Borrower must elect a prepayment/refinancing privilege for such refinanced Advance from between the options described in subparagraphs (b) and (c) of paragraph 16 of this Note (provided, however, that each of the references to "the Requested Advance Date for such Advance" in subparagraph (c) of paragraph 16 of this Note shall be deemed to be a reference to "the respective Refinancing Effective Date"). The Refinancing Election Notice delivered by the Borrower in connection with each such Refinancing Election must also specify the particular prepayment/refinancing privilege that the Borrower elects for the respective refinanced Advance. In the event that the Borrower elects for any such refinanced Advance a prepayment/refinancing privilege described in subparagraph (c) of paragraph 16 of this Note, then the interest rate for such refinanced Advance, from and after the respective Refinancing Effective Date, shall include a price (expressed in terms of a basis point increment to the applicable basic interest rate) for the particular prepayment/refinancing privilege that the Borrower

elects, which increment shall be established by FFB, as of such Refinancing Effective Date, in accordance with the principles of subparagraph (d) of paragraph 6 of this Note.

(k) In the event that the Borrower makes a Refinancing Election with respect to any Amortizing Advance, then the outstanding principal amount of such Amortizing Advance, after the respective Refinancing Effective Date, shall be due and payable in accordance with this subparagraph (k).

(1) With respect to each Amortizing Advance to which either the "equal principal installments" method or the "graduated principal installments" method for the repayment of principal applies, the amount of the quarterly principal installments that will be due after the respective Refinancing Effective Date shall be equal to the amount of the quarterly installments of equal principal or graduated principal, as the case may be, that were due in accordance with the principal repayment schedule that applied to such Amortizing Advance immediately before the respective Refinancing Effective Date.

(2) With respect to each Amortizing Advance to which the "level debt service" method for the repayment of principal applies, the amount of the level quarterly payments consisting of a principal installment and accrued interest that will be due after the respective Refinancing Effective Date shall be newly computed so that the amount of each such quarterly payment consisting of a principal installment and accrued interest (taking into account the new interest rate that applies to such Amortizing Advance from and after such Refinancing Effective Date) shall be substantially equal to the amount of every other quarterly payment consisting of a principal installment and accrued interest, and shall be sufficient, when added to all other such newly-computed level quarterly payments consisting of a principal installment and accrued interest, to repay the outstanding principal amount of such refinanced Amortizing Advance in full on the Final Maturity Date (notwithstanding the fact that the Borrower may have selected a Maturity Date for such refinanced Amortizing Advance that will occur before the Final Maturity Date).

(3) The quarterly installments of equal principal or graduated principal, or the newly-computed level quarterly payments consisting of a principal installment and accrued interest, as the case may be, shall be due beginning on the first Payment Date to occur after the respective Refinancing

Effective Date, and shall be due on each Payment Date to occur thereafter up through and including the earlier to occur of (A) the new Maturity Date that the Borrower selected for such refinanced Amortizing Advance, on which date the entire unpaid principal amount of such refinanced Amortizing Advance shall also be payable, subject to Maturity Extensions (as provided in paragraph 15 of this Note) if the new Maturity Date is an Interim Maturity Date, or (B) the date on which the entire principal amount of such refinanced Amortizing Advance, and all unpaid interest (and Late Charges, if any) accrued thereon, are paid.

(l) The Borrower may make more than one Refinancing Election with respect to any Advance.

19. Rescission of Prepayment Elections and Refinancing Elections; Late Charges for Late Payments.

(a) The Borrower may rescind any Prepayment Election made in accordance with paragraph 17 of this Note or any Refinancing Election made in accordance with paragraph 18 of this Note, but only in accordance with this paragraph 19.

(b) The Borrower shall deliver to both FFB and RUS written notification of each rescission of a Prepayment Election or a Refinancing Election (each such notification being an "Election Rescission Notice") specifying the particular Advance for which the Borrower wishes to rescind such Prepayment Election or Refinancing Election, as the case may be, which specification must make reference to both:

(1) the particular Advance Identifier that FFB assigned to such Advance (as provided in the Agreement); and

(2) the RUS account number for such Advance.

The Election Rescission Notice may be delivered by facsimile transmission to FFB at (202) 622-0707 and to RUS at (202) 720-1401, or at such other facsimile number or numbers as either FFB or RUS may from time to time communicate to the Borrower.

(c) To be effective, an Election Rescission Notice must be received by both FFB and RUS not later than 3:30 p.m. (Washington, D.C., time) on the second Business Day before the Intended Prepayment Date or the Intended Refinancing Date, as the case may be.

(d) In the event that the Borrower (1) makes a Prepayment Election in accordance with paragraph 17 of this Note or a Refinancing Election in accordance with paragraph 18 of this Note, (2) does not rescind such Prepayment Election or Refinancing Election, as the case may be, in accordance with this paragraph 19, and (3) does not, before 3:00 p.m. (Washington, D.C., time) on the Intended Prepayment Date or Intended Refinancing Date, as the case may be, pay to FFB the Prepayment Price described in subparagraph (e) of paragraph 17 of this Note or Refinancing Price described in subparagraph (e) of paragraph 18 of this Note, as the case may be, then a Late Charge shall accrue on any such unpaid amount from the Intended Prepayment Date or Intended Refinancing Date, as the case may be, to the date on which payment is made, computed in accordance with the principles of paragraph 11 of this Note.

20. Amendments to Note.

To the extent not inconsistent with applicable law, this Note, for so long as FFB or its agent is the holder thereof, shall be subject to modification by such amendments, extensions, and renewals as may be agreed upon from time to time by FFB and the Borrower, with the approval of RUS.

21. Certain Waivers.

The Borrower hereby waives any requirement for presentment, protest, or other demand or notice with respect to this Note.

22. Note Effective Until Paid.

This Note shall continue in full force and effect until all principal outstanding hereunder, all interest accrued hereunder, all premiums (if any) payable under paragraphs 17 and 18 of this Note, all Late Charges (if any) payable under paragraphs 11 and 19 of this Note, and all fees (if any) payable under paragraph 9 of this Note have been paid in full.

23. RUS Guarantee of Note.

Upon execution of the guarantee set forth at the end of this Note (the "Guarantee"), the payment by the Borrower of all amounts due and payable under this Note, when and as due, shall be guaranteed by the United States of America, acting through RUS, pursuant to the Rural Electrification Act of 1936, as amended (codified at 7 U.S.C. § 901 et seq.). In consideration of the Guarantee, the Borrower promises to RUS to make all payments due under this Note when and as due.

24. Security Instrument; RUS as "Holder" of Note for Purposes of the Security Instrument.

This Note is one of several notes permitted to be executed and delivered by, and is entitled to the benefits and security of, the particular security instrument or instruments specified on page 1 of this Note (such security instrument or instruments, as it or they may have heretofore been, and as it or they may hereafter be, amended, supplemented, restated, or consolidated from time to time in accordance with its or their terms, being, collectively, the "Security Instrument"), whereby the Borrower pledged and granted a security interest in certain property of the Borrower, described therein, to secure the payment of and performance of certain obligations owed to REA, predecessor to RUS, or to RUS, as the case may be, as set forth in the Security Instrument. For purposes of the Security Instrument, RUS shall be considered to be, and shall have the rights, powers, privileges, and remedies of, the holder of this Note.

25. Guarantee Payments; Reimbursement.

If RUS makes any payment, pursuant to the Guarantee, of any amount due and payable under this Note, when and as due, each and every such payment so made shall be deemed to be a payment hereunder; provided, however, that no payment by RUS pursuant to the Guarantee shall be considered a payment for purposes of determining the existence of a failure by the Borrower to perform its obligation to RUS to make all payments under this Note when and as due. RUS shall have any rights by way of subrogation, agreement or otherwise which arise as a result of such payment pursuant to the Guarantee and as provided in the reimbursement note executed and delivered by the Borrower to the United States of America, acting through RUS, to evidence the Borrower's obligation to reimburse RUS for payment made by RUS pursuant to the Guarantee.

26. Default and Enforcement.

In case of a default by the Borrower under this Note or a the occurrence of an event of default under the Security Instrument, then, in consideration of the obligation of RUS under the Guarantee, in that event, to make payments to FFB as provided in this Note, RUS, in its own name, shall have all rights, powers, privileges, and remedies of the holder of this Note, in accordance with the terms of this Note and the Security Instrument, including, without limitation, the right to enforce or collect all or any part of the obligation of the Borrower under this Note or arising as a result of the Guarantee, to file

proofs of claim or any other document in any bankruptcy, insolvency, or other judicial proceeding, and to vote such proofs of claim.

27. Acceleration.

The entire unpaid principal amount of this Note, and all interest thereon, may be declared, and upon such declaration shall become, due and payable to RUS, under the circumstances described, and in the manner and with the effect provided, in the Security Instrument.

IN WITNESS WHEREOF, the Borrower has caused this Note to be signed in its corporate name and its corporate seal to be hereunder affixed and attested by its officers thereunto duly authorized, all as of the day and year first above written.

ARIZONA ELECTRIC POWER COOPERATIVE, INC.
(name of Borrower)

BY:

Signature: Reuben B. McBride

Print Name: REUBEN B. MCBRIDE

Title: President

ATTEST:

(SEAL)

Signature: Lyn R. Borah

Print Name: LYN R. BORAH

Title: Secretary

FFB Note Identifier:

RUS Note Identifier:

Benson, Arizona

March 1, 2002

REIMBURSEMENT NOTE

ARIZONA ELECTRIC POWER COOPERATIVE, INC. (the "Borrower"), which term includes any successors or assigns), a corporation organized and existing under the laws of the State of Arizona, for value received, promises to pay on demand to the order of the UNITED STATES OF AMERICA (the "Government"), acting through the Administrator of the Rural Utilities Service ("RUS"), at the United States Treasury, Washington, D.C., a sum equal to:

(1) all amounts, including, without limitation, principal and interest (the "Reimbursed Amount"), paid by the Government from time to time pursuant to that certain guarantee by RUS (the "RUS Guarantee"), made by RUS to the Federal Financing Bank ("FFB") of amounts payable to FFB under a note dated March 1, 2002, made by the Borrower payable to FFB and guaranteed by RUS (the "FFB Note") pursuant to the Rural Electrification Act of 1936, as amended (7 U.S.C. 901 *et seq.*), Section 6 of the Federal Financing Bank Act of 1973 (12 U.S.C. §2285), and the Note Purchase Commitment and Servicing Agreement, as amended and as it may be amended, supplemented, or restated from time to time, dated as of January 1, 1992, between FFB and RUS (all such amounts hereinafter collectively called the "Principal Amount"), and

(2) with interest on the Principal Amount from the respective date of such payment by RUS to FFB, at the Late Charge Rate as that term is defined in the FFB Note, and

(3) administrative costs and penalty charges assessed in accordance with applicable regulations, and

(4) any and all costs and expenses incurred in connection with the exercise of rights or the enforcement of remedies, as set forth in the Security Instrument, as hereinafter defined.

The obligations of the Borrower hereunder are absolute and unconditional, irrespective of any defense or any right to set off, recoupment or counterclaim it might otherwise have against the Government.

So long as FFB has received all amounts then due to it under the RUS Guarantee, the Borrower agrees to pay all amounts due on this Note directly to RUS. Nothing herein shall limit the Government's rights of subrogation which may arise as a result of payments made by RUS pursuant to the RUS Guarantee.

This Note is one of several notes permitted to be executed and delivered by, and is entitled to the benefits and security of, the Consolidated Mortgage and Security Agreement, dated as of June 14, 1989, made by and among the Borrower, the Government and National Rural Utilities Cooperative Finance Corporation, as it may have heretofore been, or as it may hereinafter be, amended, supplemented, restated, or consolidated from time to time in accordance with its terms, being, collectively, the Security Instrument (the "Security Instrument"). The Security Instrument provides that all notes shall be equally and ratably secured thereby and reference is hereby made to the Security Instrument for a description of the property pledged, the nature and extent of the security and the rights, powers, privileges, and remedies of, the holders of notes with respect thereto.

Neither the execution and delivery of this Note by the Borrower to the Government, nor the failure of the Government to exercise any of its rights, powers, privileges or remedies under the Security Instrument shall be deemed to be a waiver of any right, power, privilege or remedy of the Government, as a holder of this Note, under the Security Instrument.

IN WITNESS WHEREOF, the Borrower has caused this Note to be signed in its corporate name and its corporate seal to be hereunto affixed and attested by its officers thereunto duly authorized, all as of the day and year first above written.

ARIZONA ELECTRIC POWER
COOPERATIVE, INC.

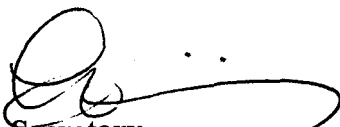
By: 

Name: REUBEN B. MCBRIDE

Title: PRESIDENT

(Seal)

Attest:


Secretary

RUS PROJECT DESIGNATION

ARIZONA 28-L8 APACHE

SUPPLEMENT TO CONSOLIDATED MORTGAGE AND SECURITY AGREEMENT

made by and among

ARIZONA ELECTRIC POWER COOPERATIVE, INC.

P. O. Box 670

Benson, Arizona 85602,

Mortgagor, and

UNITED STATES OF AMERICA

Rural Utilities Service

Washington, D.C. 20250-1500,

Mortgagee, and

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

2201 Cooperative Way

Herndon, Virginia 20171-3025,

Mortgagee

Dated as of March 1, 2002

This instrument supplements the Consolidated Mortgage and Security Agreement which was recorded as follows:

<u>COUNTY</u>	<u>DATE RECORDED</u>	<u>INSTRUMENT NO.</u>
Cochise	June 22, 1989	890612481
Gila	June 22, 1989	Docket 771, pgs. 261-317
Graham	June 22, 1989	417/377-433
Greenlee	June 23, 1989	564 DKT.167, pgs. 502-558
Maricopa	June 22, 1989	89-286026
Mohave	June 23, 1989	89-30975
Pima	June 22, 1989	Docket 08564, page 0913
Pinal	June 23, 1989	949007-1614-144
Santa Cruz	June 22, 1989	894520
**		

THIS INSTRUMENT GRANTS A SECURITY INTEREST IN A TRANSMITTING UTILITY.

THE DEBTOR AS MORTGAGOR IS A TRANSMITTING UTILITY.

THIS INSTRUMENT CONTAINS PROVISIONS THAT COVER REAL AND PERSONAL PROPERTY, AFTER-ACQUIRED PROPERTY, PROCEEDS, FUTURE ADVANCES AND FUTURE OBLIGATIONS.

ORGANIZATIONAL NUMBER: AZ0057418-9

**La Paz	June 26, 1996	96-3918
Yavapai	July 9, 1996	BK 3239, Page 576-632
No. 18 McKinley	July 13, 1989	DKT 118, Pages 934-990
NM		

SUPPLEMENT, dated as of March 1, 2002, to CONSOLIDATED MORTGAGE AND SECURITY AGREEMENT, made by and among ARIZONA ELECTRIC POWER COOPERATIVE, INC. (hereinafter called the "Mortgagor"), a corporation existing under the laws of the State of Arizona, UNITED STATES OF AMERICA (hereinafter called the "Government"), acting through the Administrator of the Rural Utilities Service (hereinafter called the "Administrator"), successor to the Rural Electrification Administration, and NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION (hereinafter called "CFC"), a corporation existing under the laws of the District of Columbia (the Government and CFC being hereinafter sometimes collectively called the "Mortgagees").

WHEREAS, pursuant to Public Law No. 103-354, the Rural Utilities Service (hereinafter sometimes called "RUS") is the successor to the Rural Electrification Administration (hereinafter sometimes called "REA") and the Administrator of the Rural Utilities Service is the successor to the Administrator of the Rural Electrification Administration and, for the purposes of the mortgage, identified in the eighth recital hereof (hereinafter called the "Instruments Recital"), as amended, the terms "REA" and "Administrator" shall be deemed to mean respectively "RUS" and "Administrator of the RUS"; and

WHEREAS, the Mortgagor, for value received, has heretofore duly authorized and executed, and has delivered to the Government, or has assumed the payment of, certain mortgage notes all payable to the order of the Government, in installments, of which certain mortgage notes (hereinafter collectively called the "Outstanding RUS Notes"), identified in the Instruments Recital, are now outstanding and held by the Government; and

WHEREAS, the Mortgagor, for value received has heretofore duly authorized and executed, and has delivered to CFC, or has assumed the payment of, a certain mortgage note, or certain mortgage notes, all payable to the order of CFC, in installments, of which the certain mortgage note or notes (hereinafter collectively called the "Outstanding CFC Note(s)") identified in the Instruments Recital are now outstanding (the Outstanding RUS Notes and the Outstanding CFC Note(s) being hereinafter collectively called the "Outstanding Notes"); and

WHEREAS, the Outstanding Notes are secured by the security instrument(s) (hereinafter collectively called the "Mortgage") made by the Mortgagor to the Mortgagees and identified in the Instruments Recital; and

WHEREAS, the Mortgagor has determined to borrow funds from the Federal Financing Bank (hereinafter called the "Guaranteed Lender") and has accordingly duly authorized, executed and delivered its mortgage note or notes (identified in the Instruments Recital and hereinafter collectively called the "Current Guaranteed Note") to be secured by the Mortgage, as amended and supplemented hereby, of the property hereinafter described; and

WHEREAS, the repayment of the Current Guaranteed Note by the Mortgagor is guaranteed by the Government, pursuant to the Rural Electrification Act of 1936, as amended (7 U.S.C. 901 et seq.), in accordance with that certain agreement identified in the Instruments Recital as, and hereinafter called, the "Contract of Guarantee", among the Mortgagor, the Government, acting through the Administrator of RUS and the Guaranteed Lender; and

WHEREAS, the Mortgagor has determined to reimburse the Government, acting through the Administrator of RUS for certain amounts paid by the Government, acting through the Administrator of RUS from time to time pursuant to the Contract of Guarantee and has accordingly duly authorized, executed and delivered its mortgage note or notes (identified in the Instruments Recital and hereinafter collectively called the "Current Reimbursement Note") to be secured by the Mortgage, as amended and supplemented hereby, of the property hereinafter described; and

WHEREAS, the instruments referred to in the preceding recitals are hereby identified as follows:

INSTRUMENTS RECITAL

"Current Guaranteed Note": (Of even date herewith):

<u>Principal Amount</u>	<u>Interest Rate</u> (per annum)	<u>Final Payment</u> <u>Date</u>
\$6,315,000	Determined when Advanced	December 31, 2020

"Current Reimbursement Note": (Of even date herewith):

<u>Principal Amount</u>	<u>Final Payment Date</u>
Determined when advance made	On demand

"Contract of Guarantee", Note Purchase Commitment and Servicing Agreement, between the Federal Financing Bank and the Administrator of RUS dated as of January 1, 1992, as amended.

"Outstanding RUS Notes":

<u>Note Designation</u>	<u>Note Date</u>	<u>Original Principal Amount</u>	<u>Maturity Date</u>	<u>% Rate</u>
A#7	2 Jul 2001	\$ 104,631.05	26 Sep 2004	2.00
A#9	2 Jul 2001	377,566.74	20 Jun 2008	2.00
B1#1	2 Jul 2001	425,110.88	15 Dec 2006	2.00
B1#2	2 Jul 2001	584,579.93	20 Jun 2008	2.00
C4	2 Jul 2001	2,167,830.02	26 Jun 2009	5.00
D4	2 Jul 2001	3,159,245.75	1 Apr 2010	5.00

"Outstanding CFC Note(s)":

<u>Note Designation</u>	<u>Note Date</u>	<u>Original Principal Amount</u>	<u>Maturity Date</u>
A-9019	12 May 1993	\$4,817,347.00	12 May 2013

Pollution Control Notes:

<u>Note Date</u>	<u>Original Principal Amount</u>	<u>Maturity Date</u>
1 Sep 1994	\$31,200,000.00	1 Sep 2024
1 Mar 1997	25,525,000.00	1 Dec 2007

"Mortgage":

<u>Instrument</u>	<u>Date</u>
Consolidated Mortgage and Security Agreement	June 14, 1989
Supplement to Consolidated Mortgage and Security Agreement	August, 1994
Supplement to Consolidated Mortgage and Security Agreement	February 13, 1996

WHEREAS, the Government and CFC are authorized to enter into this Supplement to Consolidated Mortgage and Security Agreement.

WHEREAS, it was the intention of the Mortgagor at the time of the execution of the Mortgage (or, if the mortgage consists of more than one instrument, at the time of the earliest instrument thereof) that the property of the Mortgagor of the classes described therein, as being mortgaged or pledged thereby, or intended so to be, whether then owned or thereafter acquired, would secure certain notes of the Mortgagor executed and delivered prior to the execution and delivery of the Mortgage, and certain notes of the Mortgagor when and as executed and delivered under and pursuant to the Mortgage, as from time to time amended and supplemented, and it is intended by the Mortgagor to confirm hereby the Mortgage and the property therein described as being mortgaged or pledged, or intended so to be, as security for the Outstanding Notes, and other notes of the Mortgagor when and as executed and delivered under and pursuant to the Mortgage, as amended and supplemented hereby; and

WHEREAS, the Mortgage provides that the Mortgagor shall, upon the written demand of the Government or CFC duly authorize, execute, and deliver and record and file all such supplemental mortgages and conveyances as may reasonably be requested by the Government or CFC to effectuate the intention of the Mortgage and to provide for the conveying, mortgaging and pledging of the property of the Mortgagor intended to be conveyed, mortgaged or pledged by the Mortgage to secure the payment of the principal of and interest on notes executed and delivered thereunder and pursuant thereto, or otherwise secured thereby, and the Government and CFC have in writing requested the execution and delivery of this Supplement (hereinafter called "this Supplemental Mortgage") to the Mortgage pursuant to such provision; and

WHEREAS, it is further intended by the Mortgagor, at the request and with the consent of the Mortgagees, to amend and supplement the Mortgage in the respects hereinafter set forth; and

WHEREAS, all acts, things, and conditions prescribed by law and by the articles of incorporation and bylaws of the Mortgagor have been duly performed and complied with to authorize the execution and delivery hereof and to make the Mortgage, as amended and supplemented hereby, a valid and binding mortgage to secure the Outstanding Notes and other notes of the Mortgagor when and as executed and delivered under and pursuant to the Mortgage, as amended and supplemented hereby;

WHEREAS, to the extent that any of the property described or referred to herein or in the Mortgage is governed by the provisions of the Uniform Commercial Code of any state (hereinafter called the "Uniform Commercial Code"), the parties hereto desire that this Supplemental Mortgage and the Mortgage collectively be regarded as a "security agreement" under the Uniform Commercial Code and that this Supplemental Mortgage be regarded as a "financing statement" for said security agreement under the Uniform Commercial Code.

NOW, THEREFORE, in consideration of the premises and the sum of \$5 in hand paid by the Mortgagees to the Mortgagor, the receipt whereof by the Mortgagor prior to the execution and delivery of this Supplemental Mortgage is hereby acknowledged, this Supplemental Mortgage witnesseth as follows:

1. The Mortgagor has executed and delivered this Supplemental Mortgage and has granted, bargained, sold, conveyed, warranted, assigned, transferred, mortgaged, pledged and set over, and by these presents does hereby grant, bargain, sell, convey, warrant, assign, transfer, mortgage, pledge and set over, unto the Mortgagees and their respective assigns, all and singular the real and personal property described in the Mortgage as being mortgaged thereby and all and singular the real and personal property of the Mortgagor falling within the classes of property embraced in the description of the "Mortgaged Property" set forth in the Mortgage, including, without limitation, all and singular the real and personal property of said description heretofore or hereafter acquired by or constructed by or on behalf of the Mortgagor, and wheresoever situate, including, without limitation, the "Existing Electric Facilities" identified and the real estate specifically described (by reference to deeds or otherwise) in the Mortgage and mortgaged thereby (except such portions, if any, thereof as have been released prior to the execution and delivery of this Supplemental Mortgage).

AND ALSO including, without limitation:

I

All right, title and interest of the Mortgagor in and to all extensions and improvements of the "Existing Electric Facilities", as provided above, and additions thereto, including all substations, service and connecting lines (both overhead and underground), poles, towers, posts, crossarms, wires, cables, conduits, mains, pipes, tubes, transformers, insulators, meters, electrical connections, lamps, fuses, junction boxes, fixtures, appliances, generators, dynamos, water turbines, water wheels, boilers, steam turbines, motors, switch boards, switch racks, pipe lines, machinery, tools, supplies, switching and other equipment, and any and all other property of every nature and description, used or acquired for use by the Mortgagor in connection therewith;

II

All right, title and interest of the Mortgagor in, to and under any and all grants, privileges, rights of way and easements now owned, held, leased, enjoyed or exercised or which may hereafter be owned, held, leased, acquired, enjoyed or exercised, by the Mortgagor for the purposes of, or in connection with, the construction or operation by or on behalf of the Mortgagor of electric transmission or distribution lines, or systems, whether underground or overhead or otherwise, or of any electric generating plant, wherever located;

III

All right, title and interest of the Mortgagor in, to and under any and all licenses, franchises, ordinances, privileges and permits heretofore granted, issued or executed, or which may hereafter be granted, issued or executed, to it or to its assignors by the United States of America, or by any state, or by any county, township, municipality, village or other political subdivision thereof, or by any agency, board, commission or department of any of the foregoing, authorizing the construction, acquisition, or operation of electric transmission or distribution lines, or systems, or any electric generating plant or plants, insofar as the same may by law be assigned, granted, bargained, sold, conveyed, transferred, mortgaged or pledged;

IV

All right, title and interest of the Mortgagor in, to and under any and all contracts heretofore or hereafter executed by and between the Mortgagor and any person, firm, or corporation providing for the purchase, sale or exchange of electric power or energy by the Mortgagor together with any and all other accounts, contract rights and general intangibles (as such terms are defined in the applicable Uniform Commercial Code) heretofore or hereafter acquired by the Mortgagor;

V

Also all right, title and interest of the Mortgagor in and to all other property, real or personal, tangible or intangible, of every kind, nature and description, and wheresoever situated, now owned or hereafter acquired by the Mortgagor, it being the intention hereof that all such property now owned by not specifically described herein or acquired or held by the Mortgagor after the date hereof shall be as fully embraced within and subjected to the lien hereof as if the same were now owned by the Mortgagor and were specifically described herein to the extent only, however, that the subjection of such property to the lien hereof shall not be contrary to law;

Together with all rents, income, proceeds, products, revenues, profits and benefits at any time derived, received or had from any and all of the above-described property of the Mortgagor.

Provided, however, that except as provided in section 4.13(b) of article II of the Mortgage, no automobiles, trucks, trailers, tractors or other vehicles (including without limitation aircraft or ships, if any) owned or used by the Mortgagor shall be included in the property mortgaged by the Mortgage and this Supplemental Mortgage.

TO HAVE AND TO HOLD the same forever, for the uses and purposes and upon the terms, conditions, provisos and agreements expressed and declared in the Mortgage, as amended and supplemented hereby.

2. The Outstanding Notes are hereby confirmed as notes of the Mortgagor entitled to the security of the Mortgage, as amended and supplemented by this Supplemental Mortgage, and of the property by the Mortgage and this Supplemental Mortgage mortgaged and pledged, or intended so to be, equally and ratably with one another and with other notes of the Mortgagor when and as executed and delivered under and pursuant to the Mortgage, as amended and supplemented hereby, without preference priority or distinction as to interest or principal (except, as otherwise specifically provided in the Mortgage, as amended and supplemented hereby) or as to lien or otherwise, of any one of the Outstanding Notes or such other notes over any other thereof and irrespective of the date of the execution, delivery or maturity thereof, or of the assignment or negotiation thereof or otherwise.

3. The term "Additional RUS Notes", as defined in the Mortgage, shall be amended to include additional notes guaranteed by the Government and additional notes executed and delivered to the Government in connection with the guarantee by the Government. The term "RUS Notes", as defined in the Mortgage, shall be amended to include the Current Guaranteed Note and the Current Reimbursement Note. The term "RUS Loan Agreement", as defined in the Mortgage, shall be amended to include the Contract of Guarantee and all other contracts between the Mortgagor and the Government whereby the Government guarantees the repayment by the Mortgagor of a loan or loans made by a third party or parties to the Mortgagor.

4. Any reference herein to the Administrator shall be deemed to mean the Administrator of the Rural Utilities Service or his duly authorized representative or any other person or authority in whom may be vested the duties and functions which the Administrator is now or may hereafter be authorized by law to perform.

5. All demands, notices, reports, approvals, designations, or directions required or permitted to be given under the Mortgage, as amended hereby, shall be in writing and shall be deemed to be properly given if mailed by registered mail addressed to the proper party or parties at the following addresses:

As to the Mortgagor: as stated in the testimonium clause hereof.

As to the Mortgagees: CFC: National Rural Utilities Cooperative
Finance Corporation
2201 Cooperative Way
Herndon, Virginia 22071-3025

The Government:
Rural Utilities Service
United States Department of Agriculture
Room No. 4051
1400 Independence Avenue, S.W.
Washington, D.C. 20250-1500
Fax: (202) 720-1725
Attention: Administrator

With a copy to:

Rural Utilities Service
United States Department of Agriculture
Room No. 0270
1400 Independence Avenue, S.W.
Stop 1568
Washington, D.C. 20250-1500
Fax: (202) 720-1401
Attention: Power Supply Division
Rural Utilities Service
Washington, D.C. 20250-1500

and as to any other person, firm, corporation or governmental body or agency having an interest herein by reason of being the holder of any note or otherwise, at the last address designated by such person, firm, corporation, governmental body or agency to the Mortgagor and the Mortgagees. The Mortgagor or the Mortgagees may from time to time designate to each other a new address to which demands, notices, reports, approvals, designations or directions may be addressed and from and after any such designation the address designated shall be deemed to be the address of such party in lieu of the address hereinabove given.

6. To the extent that any of the property described or referred to herein and in the Mortgage is governed by the provisions of the Uniform Commercial Code, the Mortgage and this Supplemental Mortgage, collectively, are hereby deemed a "security agreement" under the Uniform Commercial Code, and this Supplemental Mortgage is also hereby declared to be a "financing statement", for said security agreement under the Uniform Commercial Code. The mailing address of the Mortgagor as debtor, and of the Mortgagees as secured parties, are as set forth in the Mortgage and in section 5 of this Supplemental Mortgage.

7. All of the terms, provisions and covenants of the Mortgage, except as expressly modified hereby, shall be and remain in full force and effect.

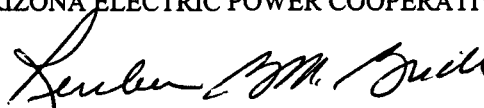
8. The invalidity of any one or more phrases, clauses, sentences, paragraphs or provisions of this Supplemental Mortgage shall not affect the validity of the remaining portions hereof.

9. This Supplemental Mortgage may be simultaneously executed in any number of counterparts, and all of said counterparts executed and delivered, each as an original, shall constitute but one and the same instrument.

IN WITNESS WHEREOF, ARIZONA ELECTRIC POWER COOPERATIVE, INC., P. O. Box 670, Benson, Arizona 85602, as Mortgagor, has caused this Supplemental Mortgage to be signed in its name and its corporate seal to be hereunto affixed and attested by its officers thereunto duly authorized, NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION, as Mortgagee, has caused this Supplemental Mortgage to be signed in its name and its corporate seal to be hereunto affixed and attested by its officers thereunto duly authorized, and UNITED STATES OF AMERICA, as Mortgagee, has caused this Supplemental Mortgage to be duly executed in its behalf, all as of the day and year first above written.

ARIZONA ELECTRIC POWER COOPERATIVE, INC.

by



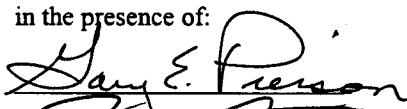
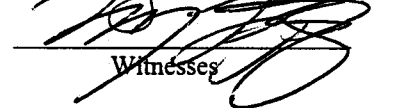
President

(Seal)

Attest:


Secretary

Executed by the Mortgagor
in the presence of:



Witnesses

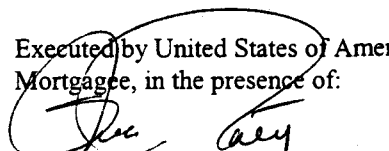
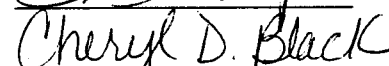
UNITED STATES OF AMERICA

by



Director, Power Supply Division
Rural Utilities Service

Executed by United States of America,
Mortgagee, in the presence of:



Cheryl D. Black
Witnesses

NATIONAL RURAL UTILITIES COOPERATIVE
FINANCE CORPORATION

by

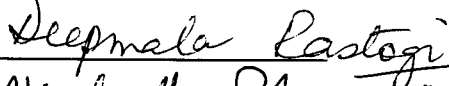


Assistant Secretary-Treasurer
DAVID FARRELL

(SEAL)

Attest:


Assistant Secretary-Treasurer

ELIZABETH S. AGUIRRE
Executed by National Rural Utilities
Cooperative Finance Corporation,
Mortgagee, in the presence of:



Witnesses

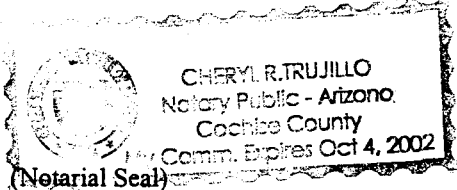
DEEPMALA RASTOGI

Michelle F. [unclear]

STATE OF ARIZONA)
COUNTY OF Cochise) SS

On this 11TH day of April, 2002, before me, the undersigned officer, personally appeared Reuben B. McBride and _____, who acknowledged themselves to be the President and Secretary, respectively, of ARIZONA ELECTRIC POWER COOPERATIVE, INC., a corporation, and that they, as such President ~~and Secretary~~, being authorized so to do, executed the foregoing instrument, for the purposes therein contained, by signing the name of the corporation by themselves as President ~~and Secretary~~.

IN WITNESS WHEREOF, I have hereunto set my hand and official seal.



Cheryl R. Trujillo
Notary Public

My commission expires: Oct 4, 2002

DISTRICT OF COLUMBIA) SS

On this 5th day of APRIL, 2002, personally appeared before me
VICTOR T. VU, who, being duly sworn, did say that he is the Director - Power
Supply Division of the Rural Utilities Service, an agency of the United States of America, and acknowledged to me that,
acting under a delegation of authority duly given and evidenced by law and presently in effect, he executed said
instrument as the act and deed of the United States of America for the uses and purposes therein mentioned.

IN TESTIMONY WHEREOF, I have heretofore set my hand and official seal the day and year last
above written.

James F. Mothershed
Notary Public
JAMES F. MOTHERSHED

(Notarial Seal)

My commission expires: JUNE 14, 2004

COMMONWEALTH OF VIRGINIA

)

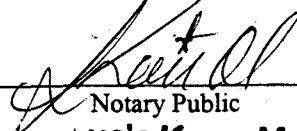
) SS

COUNTY OF FAIRFAX

)

On this 10th day of April, 20 02, before me appeared DAVID FARRELL, to me personally known, who, being by me duly sworn, did say that he is the ASSISTANT SECRETARY-TREASURER of the National Rural Utilities Cooperative Finance Corporation, and that the seal affixed to the foregoing instrument is the corporate seal of said corporation and that said instrument was signed and sealed in behalf of said corporation by authority of its board of directors and said ASSISTANT SECRETARY-TREASURER acknowledged said instrument to be the free act and deed of said corporation.

IN WITNESS WHEREOF, I have hereunto set my hand and official seal.


Notary Public

Lucia Karen Mora

(Notarial Seal)

My commission expires: 1-31-04